PROVINCE OF NEW BRUNSWICK

EXTERNAL FINANCIAL REVIEW

OCTOBER 27, 1987

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INTRODUCTION AND ACKNOWLEDGEMENTS

We have reviewed the financial affairs of the Province of New Brunswick as at October 27, 1987 in accordance with the following terms of reference.

Doane Raymond will review and report on:

1. Net debt position of the Province;

2. Forecasts of revenue and expenditures for the year ending March 31, 1988, relating such forecasts to the approved appropriations for the year;

3. Special warrants for the period April 1, 1987 to October 27, 1987;

4. Loans, advances and investments including the collectibility of and security for such loans and advances granted either directly or through crown agencies and corporations commenting on:

   - the nature of the security and purpose of such;
   - the repayment schedule and history of such;
   - the adequacy of the provision for loss reserve and recommendations, where warranted, for additional amounts that should be placed in the provision for loss (such recommendations to be incorporated into 1 and 2 above);
   - the authority under which such loans, advances and investments have been approved;

Introduction ...

5. Leases currently in force or being considered including their relationship to current market value and generally accepted leasing practices;

6. The accounts receivable of the Province recommending amounts that are judged to be uncollectible; these recommendations are to be incorporated into 1 and 2 above;

7. The status of claims on Canada under Federal - Provincial cost-sharing programs and the procedures being followed in connection with such claims;

8. Contingent liabilities and commitments of the Province as at October 27, 1987;

9. The adequacy of personnel controls;

10. Contracts in progress for capital construction;

11. Budgeting practices;

12. Cash management practices;

13. Generally, we were instructed to review and report on any significant items affecting the financial position of the Province including, but not limited to:

    - potential unfunded pension liabilities;
    - the impact of foreign currency fluctuation on expenditure forecasts;
    - the value of property held for resale; and

Introduction ...

14. We were instructed to comment on any weaknesses or deficiencies in accounting systems or procedures which were identified in the course of our review and to conduct such other reviews into the financial affairs of the Provinces as may be deemed necessary by the Steering Committee.

At the instruction of the Steering Committee, we did not complete our review of budgeting practices and cash management practices.

We wish to acknowledge the contribution made by Departmental financial and administrative staff, the Office of the Comptroller and the Office of the Auditor General. Their efforts in responding to our inquiries and providing information on a timely basis enabled us to complete our review on schedule.

SUMMARY OF MAJOR OBSERVATIONS AND RECOMMENDATIONS

MAJOR OBSERVATIONS

Page 18. Inappropriate accounting for foreign currency, hospital equipment loans and capital leases resulted in the understatement of net debt as at March 31, 1987 by $103 million. Adjusted net debt as at March 31, 1987 is $2,494 million.

Page 22. The net debt position of the Province is forecasted to increase by $437 million in the current year. This will bring the net debt position to $2,931 million by March 31, 1988.

Page 33. More special warrants were issued in the period April 1, 1987 to October 27, 1987 than in all of 1986-87. In relation to the same period in 1986-87, the rate of issue was more than 4 times higher.

Page 41. The Department of Health and Community Services has inappropriately classified contributions toward the purchase of high-tech hospital equipment as loans.

Lending programs in the Departments of Agriculture and Fisheries are poorly administered. Significant portions of both loan portfolios are in arrears on payments. Historically, the security taken for loans has not been sufficient to discharge the loans in the event of default. Loan administration and collection procedures in both Departments have been inadequate.

Summary ...

Contrary to stated accounting policies, the Department of Agriculture includes the cost of land owned by the Province in its loan portfolio.

The provision for loss on loans, advances and investments recorded at March 31, 1987 together with the Departments' estimates (1987-88 Main Estimates) of required increases during the current year are not adequate given the current status of the loan portfolios. The provision for loss on loans, advances and investments as at March 31, 1988 should be at least $19.5 million more than at March 31, 1987.

Page 89. The provision for loss on property taxes receivable as at October 27, 1987 should be increased by $5 million.

Page 100. The property held for resale account includes the cost of land, buildings and vessels that are not being held for resale. In some instances these assets are in use by the Province, while in other instances the assets are not in use but the Departments are not actively attempting to dispose of them. Inclusion of these assets in this account contradicts the stated accounting policies of the Province.

Page 107. Significant financial commitments exist which are not reflected in the Province's annual financial statements.

Summary ...

Page 113. Financial management and control of hospital construction has been inadequate. Hospital projects originally expected to cost $167,000,000 are now estimated to cost $377,000,000 when completed. The average length of time required to complete these hospital construction projects has increased from 6 to 9 years. None of the hospital projects reviewed have been completed on time or within budget.

Page 124. The Province leases about 975,000 square feet of office and warehouse space in addition to owned properties. Generally accepted leasing practices are not being followed. Standardized lease agreements are not being used, alternatives to leasing are not being considered, and tenders or invited proposals are not used to locate appropriate space at economical rates.

RECOMMENDATIONS

Page 32. We recommend that when debts are renegotiated before maturity, any unrealized gain or loss on foreign currency fluctuations be recorded in the year the transaction occurs.

Page 42. We recommend that the Department of Transportation fully provide against its loan to the New Brunswick Transportation Authority.

Page 43. We recommend that Provincial funding of hospital purchases of high-tech equipment be treated in the same manner as Provincial funding of hospital operations or Provincial funding of capital additions to hospitals.

Summary ...

We further recommend that this change in the existing method of accounting be made retroactively. This will afford consistent treatment to past, present and future transactions involving the purchase of hospital equipment.

Page 54. The Department of Fisheries should conduct a detailed evaluation of each loan in its loan portfolio. Future years' provisions for loss should be determined, at least partially, on a loan by loan basis instead of by formula.

Unless the quality of the loan portfolio improves significantly between October 27, 1987 and March 31, 1988, the Department should establish a provision for loss of at least $36.5 million as at March 31, 1988.

The Department of Fisheries should be instructed to act quickly on the recommendations provided by the Office of the Comptroller and the Office of the Auditor General.

The Department of Fisheries should charge interest on late or deficient interest payments receivable from borrowers. Procedures and, if necessary, regulations should be amended in a manner which will enable the Department to accomplish this.

The Government should conduct a detailed examination of the Fisheries Development Board lending program. This review should include such matters as:

Summary ...

- the fairness and equity of the program;
- the adequacy of the Act and Regulations in relation to the management and control of the program;
- the adequacy of existing administrative practices and procedures;
- the file documentation standards and Departmental compliance with standards; and,
- the lending and collection practices and procedures, including the nature and extent of security required on loans.

Page 63. Unless the quality of the loan portfolios improve significantly between October 27, 1987 and March 31, 1988, the Department of Commerce and Technology should establish a provision for loss on loans, advances and investments, as at March 31, 1988, of at least $3 million for the Department and at least $7.8 million for Provincial Holdings Limited.

Page 75. The Department of Agriculture should consider doing a detailed evaluation of each loan in its portfolio. The provision for losses in future years should be determined, at least partially, on a loan by loan basis instead of by formula.

Unless significant improvements occur in the Department's loan portfolio, the provision for loss as at March 31, 1988 should be at least $34.4 million.

Summary ...

The Department of Agriculture should be instructed to act quickly on the recommendations provided by the Office of the Comptroller and the Office of the Auditor General.

The Department of Agriculture should ensure that financial need is one of the criteria used to evaluate loan applications received under the Agriculture Development Act.

The Government should consider conducting an evaluation of the effectiveness of all lending programs within the Department of Agriculture.

The Government should examine the present practice of recording the cost of real property in the Department's records of Loans, Advances and Investments.

Page 81. In our opinion, the Department of Agriculture should record an additional $40,000 provision for loss against outstanding veterinary fees receivable as at October 27, 1987.

Land lease fees are closely related to the Agriculture Development Board loans on which a provision of 32.6% of the outstanding balance has been recommended. Accordingly, we recommend that the Department of Agriculture record an additional $60,000 to the provision for loss on lease fees receivable as at October 27, 1987.

Summary ...

Page 90. We recommend that the Department of Finance increase the provision for loss on property taxes receivable by an additional $5 million, in order to cover all possible losses on outstanding property taxes receivable as at October 27, 1987.

We recommend that the government reexamine the policy of recording, as revenue, property taxes on federal and 'not for profit' organizations.

Page 103. We recommend that in order to promote a conservative basis of accounting, Departments with Property Held for Resale should fully provide for loss on all properties held for a period of more than two years. When these properties are ultimately sold, the proceeds would be recorded as ordinary account revenue.

We recommend that all expenditures required to maintain assets held in the Property for Resale Accounts be charged against the Department's operating budget. Revenue earned on these assets should be included in ordinary revenue accounts.

We recommend that the Board of Management annually review each Department's intentions with respect to each property held in Property Held for Resale.

The Government should consider consolidating all assets held for resale in one Department charged with disposal responsibilities.

Summary ...

We recommend that the provision for loss on Property Held for Resale as at October 27, 1987 be increased by $8.7 million. This would represent an increase in the provision for loss in the Department of Commerce and Technology of $6.3 million and $2.4 million in the Department of Fisheries.

Page 109. The Government should consider disclosure of financial commitments for capital construction in the Province's annual financial statements.

Page 111. The Government should consider disclosure of financial commitments for grants under the Commerce and Technology Act in the Province's annual financial statements.

Page 119. The Department of Supply and Services should examine the existing management, control and accountability structure as it relates to hospital construction with a view to simplifying and improving control over existing construction projects.

The Department of Supply and Services should budget and account for capital construction on a project basis rather than on a fiscal year basis. This would enable management to control expenditures against budget for the duration of a project rather than on a year to year basis.

Summary ...

The Department of Supply and Services should re-examine the current estimated cost of completion for each hospital construction project and verify their accuracy. Reasons for the time required to complete each project should be documented.

Accountability for successful completion of existing hospital construction projects on time and within budget should be clearly assigned within the Department of Supply and Services.

The Department of Supply and Services should re-examine the present timetable for completion of each hospital in progress. An analysis should be prepared of the potential impact on the forecasted cost to complete, assuming that the timetable to completion could be advanced and additional funds could be made available in 1988-89.

The Government should explore options for completing these 6 hospital projects on a least cost basis. Options could include:

- prioritize projects in order to advance completion dates.
- altering the timetable for completion in order to reduce costs to complete.
- tendering responsibility for completion of some or all projects to general contractors at fixed prices with penalties for cost overruns and completion delays.

Summary ...

Page 134. The Department of Supply and Services should consider establishing written space procurement procedures that ensure due regard for economy is observed in fulfilling all future space requirements.

The Department of Supply and Services should consider developing standard lease agreements containing clauses that ensure administrative efficiency and economy in the procurement of lease space.

The Government should consider relocating all leasing activities to the Department of Supply and Services particularly in those instances where long term commitments are being made.

The Government should consider requiring user Departments to annually forecast their space requirements for the next 3 years.

The Department of Supply and Services should undertake a complete review of all existing leases for office space that require lease payments in excess of $16 per square foot.

The Government should review procedures followed for presentations to the Board of Management to ensure that accommodation requirements and costs are adequately addressed.

Summary ...

The Department of Supply and Services should maintain annual statistics on accommodations being used. The information could be assembled by Department and by program. The purpose would be to provide information that would help monitor growth in government accommodations in relation to growth in government programs.

In order to prevent the misuse of capital leasing as a means to acquire real property, we recommend that the Government adopt the CICA accounting treatment for capital leases. This recommendation, if retroactively applied would increase the net debt position of the Province as at March 31, 1987 by $16.7 million.

NET DEBT POSITION

We have been instructed to review and comment on the net debt position of the Province. Our review was to include all relevant information as at October 27, 1987. Accordingly, we have reviewed the build up of net debt over the past decade; the net debt position as at March 31, 1987; revenue and expenditures for the period ending October 27, 1987; the Main Estimates for 1987-88; the first and second quarter budget reports for 1987-88; and, other matters affecting net debt position. Our observations and comments follow.

General Information

Net debt, representing accumulated ordinary account deficits and net capital expenditures less accumulated earnings from sinking funds, is the figure commonly used to measure the financial position of the Province of New Brunswick.

The net debt position is determined annually by the Comptroller and presented in the Province's financial statements. The accounting principles used to determine net debt position are described in the notes to these financial statements.

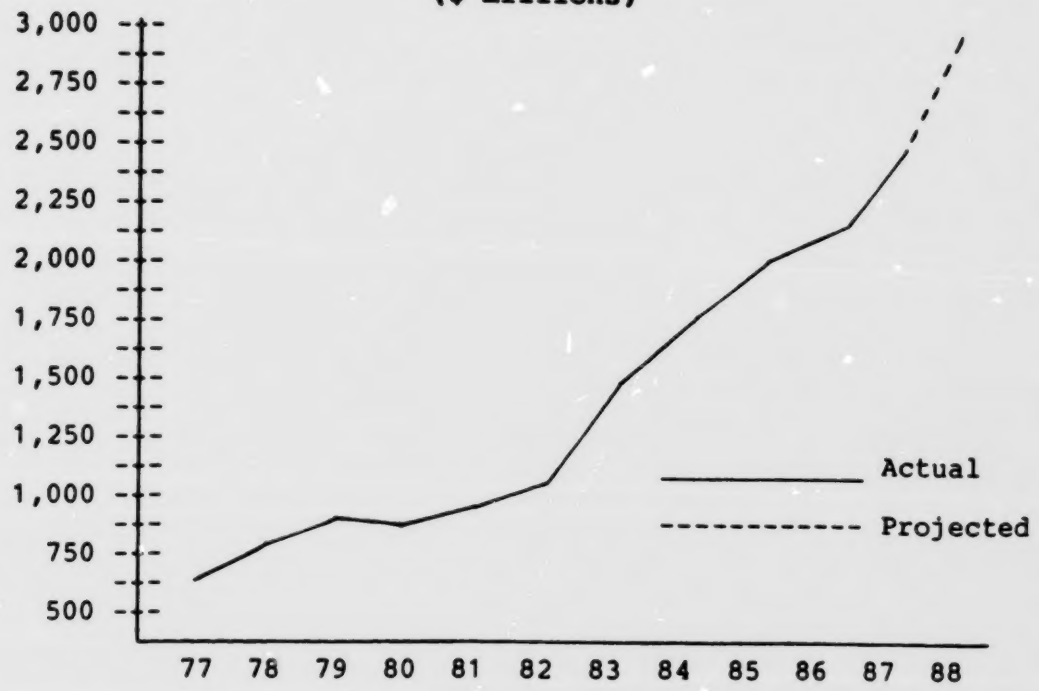
Growth in Net Debt

Over the past decade the Province's recorded net debt has grown by $1,767 million or an average of $177 million per year. In the past 5 years the rate of growth in net debt has increased to $265 million per year. Capital expenditures have been a significant contributor to net debt in each of these years.

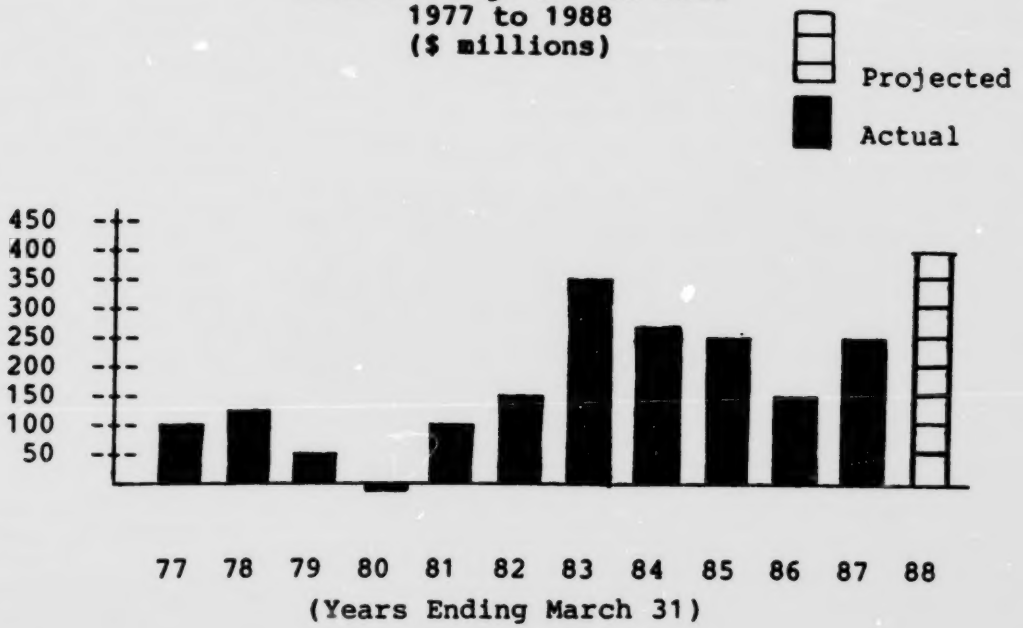
The chart on the next page depicts the growth in net debt over the past decade.

Net Debt ...

Growth in Net Debt Position
1977 to 1988
($ millions)



Annual Change in Net Debt
1977 to 1988
($ millions)



Net Debt ...

To put these figures in perspective, the net debt recorded as at March 31, 1987 amounts to about $3,300 per person resident in New Brunswick. In the past 5 years per capita debt has increased by about $1 per person per day or $365 per person per year.

Net Debt Position as at March 31, 1987

The net debt position as at March 31, 1987 as published in the Province's audited financial statements was $2,391 million. However, subsequent to year end the Government has made a retroactive change in stated accounting policies. This change, recommended by the Comptroller and the Auditor General, adopts the Canadian Institute of Chartered Accountant's approach to the treatment of foreign currency translation.

This retroactive change in accounting for foreign currency increases the net debt position as at March 31, 1987 from $2,391 million to $2,455 million.

In addition to the change in accounting for foreign currency fluctuations, there are two other accounting policies which, in our opinion, should be changed. If accepted, our recommendations would have the following impact on the net debt position as at March 31, 1987.

Net Debt ...

ADJUSTED NET DEBT POSITION
AS AT MARCH 31, 1987
($ MILLIONS)

Net Debt Position, March 31, 1987	$2,391
Adjustments	
Accounting for foreign currency fluctuations	64
	2,455
Additional adjustments recommended	
Accounting for equipment loans to hospitals	22
Accounting for capital leases	17
Adjusted Net Debt Position, March 31, 1987	$2,494

1987-88 Main Estimates

The annual increase or decrease in net debt position is to a large extent a reflection of government policies with respect to taxation and with respect to the extent of social and service programs to be undertaken. The annual budgeting exercise which culminates with the preparation of the Main Estimates reflects the anticipated cost of carrying out government policies over the coming year. Once the Main Estimates are approved by the legislature, Departments are given the authority to make expenditures as outlined in the document.

The Main Estimates for 1987-1988 indicate that expenditures are expected to exceed revenues by $324 million during the current fiscal year. Our review of this document indicates that about 75% of the total anticipated expenditures will be made in three areas: grants and contributions; civil service payroll; and, net capital expenditures.

Net Debt ...

Grants and contributions as outlined below are expected to amount to $1,777 million.

Grants and Contribution to/for:	Authorized Amount
School Boards	$ 454,500,000
Medical Care for Residents	206,800,000
Hospitals and Nursing Homes	490,600,000
Social Assistance	238,500,000
Higher Education	117,700,000
Municipalities	268,900,000
Total	$1,777,000,000

$408 million has been authorized for wages and salaries of the approximately 11,000 provincial civil servants and $353 million has been authorized as expenditures for construction of highways, bridges, schools, hospitals and other public structures.

Based on our review of actual expenditures to October 27, 1987 we believe that estimated expenditures in all three categories will be expended by March 31, 1988. These expenditures are of a nature that would require major legislative and contractual changes in order to forgo payment of the amounts approved in the Main Estimates.

1987-88 Budget Reports

During each fiscal year, the Minister of Finance, usually issues quarterly reports which update the Main Estimates based on current operating information. For the period under review, two such reports were available.

Net Debt ...

The First Quarter Report, issued by the Honourable John B. M. Baxter, reflects information available at the end of June 1987. This report shows no significant variance from the 1987-88 Main Estimates.

The Second Quarter Report, issued by the Honourable Allan E. Maher, reflects information available at the end of September 1987. This report contains significant variances from the 1987-88 Main Estimates. It suggests the increase in net debt position as at March 31, 1988 is more likely to be $387 million. A number of factors account for this difference.

1. During the period April 1, 1987 to October 27, 1987 special warrants were issued authorizing additional spending. These warrants amounted to $56 million.

2. The change in accounting for foreign exchange fluctuation affects the cost of servicing the public debt in the current year. The increase in current year's expenditures arising from this change is $11.5 million.

3. Some Departments underestimated the cost of funding ongoing programs. For example, the Main Estimates for 1987-88 did not include an appropriate amount for removing snow from public highways ($9.5 million) nor did they adequately provide for the increased cost of funding health related services ($21.8 million).

Net Debt ...

4. The impact of increases in expenditures is partially offset by increased revenue expectations. Conditional and unconditional grants from Canada are expected to generate an additional $17.6 million in revenue and federal cost-sharing related to additional capital expenditures is expected to provide an additional $17.2 million.

In our judgement, the Second Quarter Report is a more accurate estimate of the likely increase in net debt during 1987-88. Accordingly we have selected it as the basis for our forecast of the Province's net debt position as at March 31, 1988. Our forecast of revenue and expenditures is presented in the next section of this report.

Net Debt Position as at March 31, 1988

Based on the forecasted deficit presented in the next section of our report, the net debt position as at March 31, 1988 will likely be $2.9 billion.

The following schedule presents the estimated net debt position as at March 31, 1988, using the 1987-88 Main Estimates, the Second Quarter Budget Report and the 1987-88 Forecast.

Net Debt ...

ESTIMATED NET DEBT POSITION
(UNAUDITED)
AS AT MARCH 31, 1988
($ MILLIONS)

	Main Estimates	2nd Quarter Report	* Forecast
Net debt position, March 31, 1987	$2,455	$2,455	$2,494
Estimated increase in net debt	324	387	437
Net debt position, March 31, 1988	$2,779	$2,842	$2,931

* The forecasted net debt position assumes acceptance of all recommendations contained in this report.

Other Matters Affecting Net Debt Position

Stated accounting policies play a significant role in the ultimate determination of a province's net debt position. Over time most enterprises adopt accounting policies that are generally accepted within their particular industry or within the nation in which they operate. By doing so, informed readers are provided an opportunity to compare and judge the financial position of similar enterprises. Without the application of generally accepted accounting policies by similar enterprises, meaningful comparisons are difficult to accomplish.

The Public Sector Accounting and Auditing Committee of the Canadian Institute of Chartered Accountants (CICA) has developed, and continues to develop, accounting principles for governments in Canada. To date, these principles have not been fully adopted

Net Debt ...

by the Province of New Brunswick or, for that matter, by many other provinces. We support the CICA belief that a common set of accounting policies should be in use by all provinces in Canada. Yet the new administration and the public should be aware of how significant the impact can be when changes are made to existing accounting policies. The retroactive change in the stated accounting policy for foreign currency translation, described previously, is a case in point. The change of this single policy gives recognition to additional net debt of $64 million as at March 31, 1987.

In the Auditor General's 1987 Annual Report he compares the Province's financial statements with the "General Standards of Financial Statement Presentation for Governments" recommended by the CICA. There are 7 areas where the Province's financial statements differ substantially from those recommended. While all are important, 2 bear specific mention in this section of our report. They are accounting for employee pension obligations and accounting for government agencies and enterprises.

Our comments with respect to both topics are intended for information purposes only. We did not review either matter in sufficient detail to make specific recommendations. We suggest that the advice of the Comptroller and the Auditor General be considered before any action is taken on these matters.

Net Debt ...

Employee Pension Obligations

According to the Province's 1986-87 audited financial statements, the unfunded pension liability as at March 31, 1987 amounted to $1,386 million. If the existing financial statement format was changed to conform with the presentation recommended by the CICA, the net debt of the Province could increase by as much as $1.4 billion dollars. This increase would give recognition to a liability which is presently disclosed by way of a note to the financial statements.

Total net debt, as at March 31, 1987, including unfunded pension liabilities increases to $3.8 billion.

Government Agencies and Enterprises

At present the Province's financial statements do not include a summary statement consolidating or combining the Consolidated Fund financial statements with the financial statements of other government entities.

Entities such as the New Brunswick Liquor Commission, the New Brunswick Housing Corporation and Provincial Holdings Limited prepare separate financial statements. The Province's investment in these organizations is shown on the annual Statement of Financial Position as a receivable, loan, advance or investment. If the accounts of these enterprises were to be consolidated or combined with the Provincial accounts, the recorded value of fixed assets held in these enterprises could become an adjustment to net debt in the summary statement. Based on 1987 financial

Net Debt ...

statements for these enterprises the combined net debt could increase by about $80 million. If the accounts of the New Brunswick Power Corporation were combined the impact could be substantially higher.

FORECAST OF REVENUE AND EXPENDITURES FOR THE YEAR ENDING MARCH 31, 1988

Our review of the Departmental forecasts of revenue and expenditures for the year ending March 31, 1988 focused on information supplied by Departments in support of their second quarter budget reports. Our review of these reports included discussions with senior accounting and administrative officials; comparison of their budgets with actual results to October 27, 1987; and comparison with the prior year's actual figures.

The summary tables presented on the following pages compare forecasted revenues and expenditures to the original 1987-88 Main Estimates and to the Second Quarter Budget Report.

Significant deviations between the Main Estimates and the Second Quarter Budget Report have been explained in our report on Net Debt Position. Deviations between the Forecast and the Second Quarter Report (marked with an *) are explained further on in this section.

Forecast ...

FORECASTED REVENUES
(UNAUDITED)
FOR THE YEAR ENDING MARCH 31, 1988
($ MILLIONS)

Revenue Sources	1987-88 Main Estimates	Second Quarter Report	Forecast
Taxation	$1,528	$1,526	$1,526
Return on Investment	97	98	98
Licenses and Permits	52	53	53
Sale of Goods and Services	27	29	29
Royalties	25	26	26
Lottery Revenue	23	20	20
Fines and Penalties	2	2	2
Other	3	3	3
Revenue from own Sources	1,757	1,757	1,757
Unconditional Grants	972	984	984
Conditional Grants	228	234	234
Revenue from Canada	1,200	1,218	1,218
Total Ordinary Revenue	$2,957	$2,975	$2,975
Total Capital Recoveries	$29	$46	$46

Forecast ...

FORECASTED EXPENDITURES
(UNAUDITED)
FOR THE YEAR ENDING MARCH 31, 1988
($ MILLIONS)

Department	1987-88 Main Estimates	Second Quarter Report	Forecast	
Advanced Education and Training	$ 66	$ 68	$ 68	
Agriculture	22	25	27	*
Alcoholism and Drug Dependency	7	7	7	
Board of Management	6	6	6	
Cabinet Secretariat	3	3	3	
Commerce and Technology	15	17	25	*
Regional Technology Corporation	41	43	43	
Education	486	487	487	
Executive Council	1	1	1	
Finance	14	14	16	*
Fisheries	15	20	23	*
General Government - Salaries	24	30	30	
General Government - Other	89	89	89	
Health and Community Services	811	833	833	
Income Assistance	264	264	264	
Justice	72	73	73	
Labour	26	33	33	
Legislative Assembly	10	10	10	
Higher Education Commission	118	118	118	
Municipal Affairs and Environment	295	295	295	
Natural Resources and Energy	41	44	44	
New Brunswick Housing Corporation	19	19	19	
Office of the Comptroller	6	6	6	
Office of the Premier	1	1	1	
Service of the Public Debt	431	435	450	*
Supply and Services	36	36	36	
Tourism, Recreation and Heritage	32	33	33	
Transportation	111	120	140	*
Total Ordinary Expenditures	$3,062	$3,130	$3,180	
Total Capital Expenditures	$ 353	$ 384	$ 384	

Forecast ...

FORECASTED INCREASE IN NET DEBT
(UNAUDITED)
FOR THE YEAR ENDING MARCH 31, 1988
($ MILLIONS)

	1987-88 Main Estimates	Second Quarter Report	Forecast
Ordinary Account Expenditures	$3,062	$3,130	$3,180
Ordinary Account Revenues	2,957	2,975	2,975
Deficit on Ordinary Account	105	155	205
Capital Account Expenditures	353	384	384
Capital Account Recoveries	29	46	46
Deficit on Capital Account	324	338	338
Overall Deficit	429	493	543
Sinking Fund Earnings	105	106	106
Increase in Net Debt	$ 324	$ 387	$ 437

Agriculture

The Main Estimates for the Department of Agriculture authorized an increase in the provision for loss of $2,525,000. The second quarter budget report increased this estimate to $5,025,000.

Forecast ...

Our report contains recommendations for increases in the provision for loss as follows.

Accounts receivable	$ 100,000
Loans and advances	7,000,000
Total	$7,100,000

Therefore we have increased the forecasted expenditures of the Department by $2 million.

Commerce and Technology

The Main Estimates for the Department of Commerce and Technology authorized an increase in the provision for loss of $1,000,000. The second quarter report did not change this estimate.

Our report contains recommendations for increases in the provision for loss as follows.

Loans and Advances	$ 500,000
Provincial Holdings Ltd.	2,000,000
Property Held for Resale	6,300,000
Total	$8,800,000

Therefore we have increased the forecasted expenditures of the Department by $7.8 million.

Forecast ...

Finance

The Main Estimates for the Department of Finance authorized an increase in the provision for loss of $3,100,000. The second quarter report did not change this estimate.

Our report recommends an increase in the provision for loss on property taxes receivable of $5,000,000. Therefore we have increased the forecasted expenditures of the Department by $1,900,000.

Fisheries

The Main Estimates of the Department of Fisheries authorize an increase in the provision for loss of $4,300,000. The second quarter report increases this amount to $9,300,000.

Our report recommends an increase in the provision for loss made up as follows.

Loans and Advances	$10,000,000
Property Held for Resale	2,400,000
Total	$12,400,000

Therefore we have increased the forecasted expenditures of the Department by $3,100,000.

Service of the Public Debt

The Main Estimates made provision for $431 million in expenditures for servicing the public debt. The second quarter report increased this amount to $435 million. We recommend that the amount be increased by an additional $15 million.

Forecast ...

During the period April 1, 1987 to October 27, 1987 the Department of Finance redeemed debts issued in a foreign currency and reissued a similar amount in the same currency. The net effect of the transaction was a $15 million foreign exchange loss. The Department considered the transaction a renegotiation of the existing debt and elected to amortize the $15 million exchange difference over the life of the new issue. While this is an accepted accounting approach, an alternative and more conservative treatment, would have been to recognize the $15 million in the current period.

RECOMMENDATION

1. We recommend that when debts are renegotiated before maturity, any unrealized gain or loss on foreign currency fluctuations be recorded in the year the transaction occurs.

Transportation

Our report recommends a provision for loss of $20 million against loans and advances held by the Department of Transportation. The 1987-88 Main Estimates did not authorize any increase in the Departments provision for loss.

SPECIAL WARRANTS

Section 34 of the Financial Administration Act permits the issuance of special warrants for the "public good". Special warrants are used to authorize expenditures not authorized or provided for in the "main estimates" passed by the legislature.

We reviewed all special warrants issued during the period April 1, 1987 to October 27, 1987. In total there were 41 special warrants issued with a value of $56,367,540. Of these, 33 with a value of $24,193,540, related to the ordinary account; eight, with a value of $32,174,000, were for the capital account.

The use of special warrants during the first seven months of fiscal 1987-88 increased significantly in relation to prior years. By way of comparison there were 22 special warrants issued in all of the 1986-87 fiscal year, there were 29 in fiscal 1985-86 and 22 in fiscal 1984-85.

The following table illustrates the increase in both usage and value of special warrants issued.

	($ Thousands)					
	1987-88		1986-87		1985-86	
	#	Value	#	Value	#	Value
July	4	$29,996	1	$8,100	2	$2,296
August	5	7,050	2	791	3	1,261
September	23	12,533	3	570	5	4,997
October	9	6,788	3	3,321	3	2,446
	41	$56,367	9	$12,782	13	$11,000

Warrants ...

Our analysis revealed the following information on a Departmental basis.

	($ Thousands) 1987-88		1986-87	
Department	#	Value	#	Value
Advanced Education and Training	**1**	**$1,546**	**1**	**$ 641**
Alcoholism and Drug Dependency Commission	1	50		
Commerce and Technology	2	2,400		
Community Improvement Corporation	4	2,900		
Job Protection Unit	5	514		
General Government	1	50		
Health and Community Services	5	608		
Legislative Assembly			1	70
Income Assistance	1	983		
Labour	5	7,116		
Municipal Affairs and Environment	3	7,155	3	730
Natural Resources and Energy	4	2,903	2	8,250
Tourism, Recreation and Heritage	7	3,142	1	191
Transportation	2	27,000	1	2,900
	41	$56,367	9	$12,782

Our observations, drawn from a review of each warrant, follow.

Advanced Education and Training - $1,545,500

This warrant related to a contract training program. The Department administers the provision of specific training needs on a cost recovery basis. There is an offsetting recovery of funds equal to the direct costs of the program plus a charge of 7% for overhead.

Warrants ...

Alcoholism and Drug Dependency Commission - $50,000

A grant of $50,000 was made by order in council #87-800 on September 17, 1987. The beneficiary of this grant is an alcoholism and chemical dependency recovery home in Saint John. The grant is subject to certain requirements and is to be paid in installments. We were advised that, as of November 24, 1987, the recovery home has not confirmed acceptance of the conditions.

Commerce and Technology - $2,400,000

There were two warrants totalling $2,400,000 requested by this Department for the Small Industry Financial Assistance Program. The Department appears to regularly overcommit its budget related to this program. Commitments carried forward to 1987-88 amounted to $3,419,999. The original budget for 1987-88 amounted to $4,280,800. This would indicate that new commitments for 1987-88 should not have exceeded $860,801. However, the actual new commitments to October 27, 1987 amounted to $4,953,105 plus there are estimated additional commitments of $3,000,000 to March 31, 1988. After the receipt of the special warrants there will be a projected commitment carried forward to 1988-89 of $4,692,304.

Warrants ...

Special warrants are being used to meet the cash flow requirements of the program. The following schedule illustrates this point.

Commitment carried forward from 1986-87	$3,419,999
Commitments to October 27, 1987	4,953,105
Projected Commitments to March 31, 1988	3,000,000
	11,373,104
Original budget for 1987-88	4,280,800
	7,092,304
Special Warrant	2,400,000
Projected carry forward to 1988-89	$4,692,304

Community Improvement Corporation - $2,900,000

Three special warrants totalling $1,900,000 were recommended to the government in order to provide funds for projects ineligible for funding under the Canada-New Brunswick Subsidiary Agreement on Tourism Development. The warrants, when added to an original budget of $680,000, provide total funding of $2,580,000 for this purpose. As of October 27, 1987, 86 projects totalling $2,555,167 had been funded by the Department of Tourism, Recreation and Heritage.

A fourth warrant for $1,000,000 related to possible solutions to the flooding problem in the Simonds area.

Job Protection Unit - $514,000

The Job Protection Unit received five special warrants totalling $514,000. Four companies were assisted in order to protect an estimated 120 jobs. In addition, various citizen advisory committees were provided with funds to support a number of studies.

Warrants ...

General Government - $50,000

A warrant for $50,000 was authorized for the purpose of establishing an inquiry commission into the Offices of Attorney General and Department of Justice. The study has been suspended and it is anticipated that the balance of the approved funds will be frozen.

Health and Community Services - $607,990

There were four operating warrants and one capital warrant issued to this Department. Three of the operating warrants were issued to provide financial support to three organizations; Our Place - $43,520; Atelier le Rayon - $26,000; and CNIB - $146,470. The fourth, amounting to $292,000, was approved for the Hospital Services Program. This program relates to cancer services, hemophilia services and pain management services. The Department expects to spend these funds before year end.

The capital warrant, amounting to $100,000, was requested to provide funds to a Health Center. No funds have been spent to date and it is not anticipated that there will be any expenditure by year end.

Income Assistance - $983,400

A special warrant in the amount of $983,400 was required to provide for the rate increase in both regular and extra care, special care homes. As a result of the Department's second quarter review, indications are that approximately $900,000 of this warrant may not be required prior to year end.

Warrants ...

Labour - $7,116,150

There were five warrants issued to the Department of Labour. The Department requested 'start-up' funds of $96,150 to prepare regulations for 'the Pension Benefits Act' which is anticipated to be proclaimed January 1, 1989.

The Government asked the Department to request four warrants totalling $7,020,000 in order to support the Employment Technology Program. A supplementary Employment Action Program required $5,000,000 in funding. A special employment development initiatives program costing $800,000 was established to support unemployed Crab Processing workers. A special initiative in cooperation with the Department of Natural Resources and Energy was established to employ forestry workers. This program cost $1,220,000.

Municipal Affairs and Environment - $7,155,000

The Department received three warrants during the period under review. The first warrant, for $4,000,000, related to flood damage during the period March 31, 1987 to April 6, 1987. Approximately $3,600,000 of this expenditure is expected to be recovered from the Federal Government. The second warrant, for $3,000,000, was requested in order to provide funds under the Water Pollution Control Act. When the Main Estimates were prepared, a number of requests for funding under this Act were not provided for. This special warrant provided the requested funds. The third warrant, for $155,000, provided increases in stimulation grants to three municipalities.

Warrants ...

Natural Resources and Energy - $2,903,000

This Department received funding from four warrants. The first, amounting to $80,000, related to Wildlife Habitat Canada. The Department informs us that this amount is fully recoverable. The second warrant, for $280,000, was requested to supplement the Department of Labour warrant for $1,220,000 relating to employing forestry workers. We are advised by the Department that $150,000 of the $280,000 will not be required. The third warrant, for $243,000, was requested to extend the employment period for 169 Forest Wardens to December 12, 1987. The final warrant, amounting to $2,300,000, was issued in order to increase the forest fire suppression budget from $500,000 to $2,800,000.

Tourism, Recreation and Heritage - $3,142,500

The Department obtained seven warrants, totalling $3,142,500. These were in addition to those received indirectly through the Community Improvement Corporation.

$1,048,000 was requested in order to provide funds to various organizations under the Cultural Technology Branch. An additional $119,500 was obtained in order to fund various tourist information centers and $56,000 was required for feasibility studies and extended operations.

Capital warrants were used to acquire two properties for $275,000. Funds totalling $675,000 were requested for the Mactaquac Headpond cleanup, the Artifact Storage Facility, the Saint John City Market and the Bi-Capital Theatre. A final capital warrant of $969,000 was used to support six park projects, including carry-over work from previously authorized projects, and to prepare winter facilities for operation.

Warrants ...

Transportation - $27,000,000

The Department received two capital warrants amounting to $27,000,000. The first, for $25,000,000, funds construction of a highway under a federal - provincial cost sharing program. The federal share of this project is expected to be about $17,500,000. Therefore the net capital expenditure should be $7,500,000. The Department indicates that about $23,000,000 will likely be spent by year end. This should result in a net capital expenditure of about $6,900,000. The second warrant, for $2,000,000, relates to funding construction of various permanent highways.

Additional Special Warrants

During the period April 1 to October 27, 1987, Cabinet approved increases in some departmental expenditure limits without issuing special warrants. In order for departments to expend funds beyond amounts authorized by the 1987-88 Main estimates, special warrants will be required before the end of the fiscal year.

A case in point is the Department of Agriculture. The 1987-88 Main Estimates authorized $6 million in funding for new loans under the Agriculture Development Act. On October 7, 1987 Cabinet approved a $2 million increase in funding for new loans. Before March 31, 1988 the Department will be requesting a special warrant relating to this increase.

LOANS, ADVANCES AND INVESTMENTS

The value of loans, advances and investments recorded as assets in the financial statement of the Province have a significant impact on the Province's net debt position.

Funds provided as loans, advances or investments are not considered to be expenditures for purposes of determining the Province's net debt position. Only the provision for loss and the interest earned on loans have any impact on net debt. Unless adequate provision is made each year, for both potential loan losses and uncollectible interest, the net debt of the Province is understated.

The balance of loans, advances and investments, before the provision for loss, recorded as at October 27, 1987 amounted to $394.9 million. This represents a net increase of about $2.5 million over the balance as at March 31, 1987. The following schedule compares balances by Department.

Summary of Loans, Advances and Investments
($ Millions)

Department	Balance Outstanding at October 27	March 31
Agriculture	$87.5	$86.9
Commerce and Technology	18.7	19.0
Provincial Holdings Limited	26.7	23.6
Fisheries	94.1	91.5
Health and Community Services	24.5	26.3
New Brunswick Housing Corporation	92.3	93.8
Transportation	20.6	20.3
All other Departments	30.5	31.0
Total	$394.9	$392.4

Loans ...

Our review of loans, advances and investments focused on such matters as the collectibility and security of loans or advances and on the adequacy of the provision for loss recorded by the Department. We reviewed only those Departments specifically mentioned above.

Our observations and recommendations follow.

Department of Transportation - $20.6 million

The Department of Transportation has advanced $20 million to the New Brunswick Transportation Authority. The Authority, in turn, loaned a similar amount to the Saint John Port Corporation for port improvements. We understand that repayment by the Port to the Authority is linked to Port profits and that the Authority will not have sufficient resources to repay the $20 million advance from the Department unless the Port repays its loan. We have been advised that the Port has not reported profits in recent years.

RECOMMENDATION

1. We recommend that the Department of Transportation fully provide against its loan to the New Brunswick Transportation Authority.

New Brunswick Housing Corporation - $92.3 million

The amount outstanding from the New Brunswick Housing Corporation represents the Province's investment in and advances to this crown corporation. The March 31, 1987 provision for loss of $4,570,950 represents the actual amount of provision for loss recorded by this crown corporation in its own records.

Loans ...

The accounting firm of Thorne Ernst & Whinney has been engaged to review and report on the financial affairs of the New Brunswick Housing Corporation. Their report will include information with respect to the Corporation's loans, advances and investments and the adequacy of it's provision for loss. Any changes in the Corporation's provision for loss, recommended by Thorne Ernst & Whinney, will also apply to the Province's accounts.

Department of Health and Community Services - $24.5 million

As at October 27, 1987 the Department has outstanding loans to hospitals amounting to $20 million and a loan to a private corporation of $4.5 million. The balances of these loans as at March 31, 1987 were $21.7 and $4.6 respectively. The Department has not recorded a provision for loss against any of these loans.

In the Auditor General's 1985 Annual Report (paragraph 3.57) specific mention is made of the Department's loans to hospitals. The Auditor General concluded that loans to hospitals for purchase of high-tech equipment should not be included as net realizable assets of the Province because funding for repayment will be provided through future appropriations.

We share the Auditor General's views on this matter.

RECOMMENDATIONS

1. We recommend that Provincial funding of hospital purchases of high-tech equipment be treated in the same manner as Provincial funding of hospital operations or Provincial funding of capital additions to hospitals.

Loans ...

2. We further recommend that this change in the existing method of accounting be made retroactively. This will afford consistent treatment to past, present and future Provincial funding of hospital purchases of high-tech equipment.

Department of Fisheries - $94.1 million

The Department of Fisheries administers the lending program authorized by the Fisheries Development Act. The stated intention of this program is to aid and encourage the establishment or development of fisheries in the Province. This is carried out by providing financial assistance in the form of loans at favorable interest rates in order to enable fishermen to acquire new or used vessels, to carry out major repairs and refits to vessels, to purchase major pieces of fishing equipment, to construct weirs and to establish aquaculture facilities.

Loans - Fisheries ...

FISHERIES DEVELOPMENT ACT
PROGRAM HISTORY
($ Thousands)

	1984-85	1985-86	1986-87	PERIOD ENDING 10.27.87
Balance beginning of year	$69,000	$77,547	$85,024	$91,529
New loans	14,492	13,132	14,283	6,949
	83,492	90,679	99,307	98,478
Repayments	5,082	6,328	7,720	4,519
Write offs and miscellaneous adjustments	863	(673)	58	(110)
Balance end of year	$77,547	$85,024	$91,529	$94,069
Provision for loss	$12,427	$25,281	$26,029	
Provision as a percentage of loan	16.0%	29.7%	28.4%	

The amount outstanding as at October 27, 1987 represents a significant number of loans issued under this program. Accordingly, our procedures included a general review of the lending process, selected loan files, repayment schedules and repayment histories, loss experience, collection policies and procedures, and the adequacy of the provision for loss.

Our findings, observations and recommendations with respect to the Department of Fisheries follow.

Loans - Fisheries ...

OBSERVATIONS

Related Financial Statement Amounts

In order to fully appreciate the magnitude of the assistance granted under the provisions of the Fisheries Development Act it is necessary to consider two related financial statement accounts. They are Accrued Interest Receivable and the Properties Held for Resale.

Amounts included in these two accounts result from transactions originating in the lending program. As at October 27, 1987 the Accrued Interest Receivable account includes $10,215,730 in unpaid interest earned on Fisheries loans. At the same date the Properties Held for Resale account includes $4,804,004 in vessels acquired through the lending program.

Total assets related to the Fisheries lending program as at October 27, 1987 compared to March 31, 1987 are summarized as follows.

	($ Millions) Balance Outstanding at	
Financial Statement Account	October 27	March 31
Property Held for Resale	$ 4.8	$ 4.9
Accrued Interest Receivable	10.2	10.0
Loans, Advances and Investments	94.1	91.5
Total	$109.1	$106.4

Details of the Property Held for Resale account are provided later in this report.

Loans - Fisheries ...

The balance in the Accrued Interest Receivable account represents unpaid interest. Separate financial statement presentation of unpaid interest occurs both in the Fisheries lending program and in the Commerce and Technology lending program. In the Agriculture loan programs unpaid interest is included in loan balances and presented as part of the Loans, Advances and Investments balance in the Province's financial statements.

Another observation related to this Department's Accrued Interest Receivable is that no interest is charged on the balance of interest due but unpaid. In most conventional lending programs unpaid loan interest becomes part of the outstanding loan balance and earns interest at the stated rate.

Concentration of Loans

There are approximately 1700 loans outstanding within this lending program as at October 27, 1987. However, our analysis of loans indicates that 71% ($67 million) of the total dollars outstanding are concentrated in loans to about 120 borrowers.

We reviewed a limited number of loan files related to these borrowings. Based on our review we offer the following observations related to how loan concentration occurs.

Loans - Fisheries ...

Multiple loans to the same borrower appear to occur in a number of situations.

- borrower obtains funds to improve or maintain the asset acquired with the first loan;
- borrower trades vessels, borrows for the difference and has the old loan added to the new loan; or
- Department pays insurance premiums on assets held as security.

Payments of Insurance Premiums

Terms of loan agreements typically require the borrower to insure assets acquired with loan proceeds and to provide that insurance proceeds are payable to the Province. In many cases the insurance premiums are paid by the Department because notice of cancellation for non-payment of premiums is received from the insurer. On large vessels these premiums can be significant. One loan reviewed by us included $161,300 in unpaid insurance premiums.

Loans with Payments in Arrears

When one or more payments on a loan are in arrears the entire balance can be considered to be in default. The Department's current portfolio of loans includes 928 loans, totalling $64 million, for which one or more payments are in arrears.

This means that 68% of the total dollars outstanding are technically in default. If recent loans (first payment due after October 27, 1987) are excluded from the total, this percentage increases to 82%.

Loans - Fisheries ...

Collection Policy

Our analysis indicates that most loans are permitted to remain in arrears for many years before strong collection actions are undertaken. The Department does not appear to enforce a clear policy of pursuing delinquent accounts, even when information in the loan files indicates that the borrower has the ability to repay the loan. For example, in one instance we noticed financial statements in a loan file showed dividend payments of $100,000 when the company was in arrears on loan payments to the Department.

In addition the Department does not appear to have a clear policy on when, and under what circumstances, repossession and disposal of encumbered assets should be used to collect loans in default.

Adequacy of Loan Security

The Department generally does not seek additional security for additional loans. The security provided by the borrower for the first loan is normally accepted as security for additional loans related to that asset. Therefore, each subsequent loan increases the risk that the security provided to the Department is not sufficient to discharge all loans outstanding in the event of loss.

Our review of loan files also indicated that in at least one instance a loan was provided for an amount well in excess of the appraised value of the security.

Loans - Fisheries ...

The consequences of lending without adequate security can be significant. A case in point involves a vessel which sank in 1985. At the time of sinking, the outstanding loan amounted to $2,026,900. The insurance proceeds amounted to $1,095,000. The outstanding loan balance included the loan to purchase the vessel, an old loan balance transferred to the account, unpaid insurance premiums and unpaid interest.

The loan referred to above is still listed in the Department's loan portfolio even though the security no longer exists and no payments have been made since 1985.

Loss Experience

Over the past five years the Department has taken proceedings to collect 69 loans totalling $2.7 million. The amount realized on collection of these loans amounted to $798,403. Thus, the loss on collection amounted to $1,931,481 or 71.5%.

At October 27, 1987 the Department was proceeding to dispose of security held on four defaulted loans. The total amount owing on these loans amounts to $111,329. According to the Department the market value of the vessels is about $23,600.

The loan balances have been transferred to the Property Held for Resale account until such time as the security is sold.

Provision for Loss

The Department uses a formula to determine the amount of provision for loss necessary at the end of each year. The formula is based on an aging of loans with payments in arrears.

Loans - Fisheries ...

The provision for loss as at March 31, 1987 amounted to $26,029,000 or 28.9% of the outstanding loan balances. The provision has been growing steadily in relation to the total outstanding loans. In 1982 the provision for loss was only 10.8% of total outstanding loans.

This growth in the provision for loss may indicate a growing trend in payment delinquency.

Provision for Loss as at October 27, 1987

To assist with our review of Forecasted Revenue and Expenditures to March 31, 1988, we considered it appropriate to determine a Provision for Loss as at October 27, 1987. Accordingly, we selected 282 loans totalling $76.6 million and asked the Department to provide their opinion as to the net realizable value of each loan. The Department's loan by loan provision for loss against these loans amounted to $29,740,780 or 38.8% of the outstanding balances.

We have applied the results of this loan by loan analysis to the total loan portfolio. The resulting provision for loss amounts to $36.5 million. Therefore, unless the quality of the loan portfolio improves significantly, the provision for loss as at March 31, 1988 should be at least $10 million higher than it was at March 31, 1987.

Loans - Fisheries ...

Adequacy of Loan Agreements and File Documentation

We observed a number of weaknesses in loan agreements and in file documentation.

1. Many loan agreements contain partially hand written documentation and also contain blank paragraphs which have not been completed nor deleted. These hand written sections and/or blank paragraphs are not initialled by the parties to the agreement.

2. Instances were noted where signatures of the parties were not properly witnessed.

3. The lending process requires a lending officer to obtain copies of invoices for assets purchased with loan proceeds. We noted instances where copies of invoices were not in the loan files.

4. Instances were noted where appraisals supporting the purchase price of used vessels were not in the loan files.

Comments by the Comptroller

In 1986 the Comptroller reported on the results of his operational audit of the loan program administered by the Department. His report notes a number of deficiencies in the area of repossessions, additional loans to clients with loans in arrears, financial analysis of loan applications and general Departmental policy. The Comptroller offered recommendations for improvement in each of these areas.

Loans - Fisheries ...

Our review indicates that, to date, the recommendations of the Comptroller have not been implemented.

Comments by the Auditor General

In the Auditor General's annual report for 1986 the following recommendations were made regarding the financial assistance program under the Fisheries Department Act administered by the Department.

Para. 4.67 I recommend that procedures be documented to cover: the method of determining interest subsidies, since applicants with significant assets may not need to be fully subsidized; the need for security on certain loans in addition to the vessel itself; and, the reinvestment of insurance proceeds when a vessel is required to be replaced.

Para. 4.72 In my opinion, if the recommendation of the Board is not accepted (regarding a loan application), the reasons for this should be documented in the applicant's file.

Para. 4.79 I recommend that evidence of insurance coverage be kept on file at all times to protect the Province's financing position and to comply with regulations under the Act.

Loans - Fisheries ...

RECOMMENDATIONS

1. The Department of Fisheries should conduct a detailed evaluation of each loan in its loan portfolio. Future years provisions for loss should be determined, at least partially, on a loan by loan basis instead of by formula.

2. Unless the quality of the loan portfolio improves significantly between October 27, 1987 and March 31, 1988, the Department should establish a provision for loss on loans, as at March 31, 1988 of at least $36.5 million. This would represent an increase of $10 million for the year.

3. The Department of Fisheries should be instructed to act on the recommendations of the Comptroller and the Auditor General.

4. The Department of Fisheries should amend procedures and, if necessary, regulations in order to charge interest on overdue interest payments.

Loans - Fisheries ...

5. The Government should conduct a detailed examination of the Fisheries Development Board lending program. This review should include such matters as:

   - the fairness and equity of the program;
   - the adequacy of the Act and Regulations in relation to the management and control of the program;
   - the adequacy of existing administrative practices and procedures;
   - the file documentation standards and departmental compliance with standards; and,
   - the lending and collection practices and procedures, including the nature and extent of security required on loans.

Department of Commerce and Technology - $18.7 million
and
Provincial Holdings Limited - $26.7 million

The Department of Commerce and Technology administers the lending program under the Commerce and Technology Act and administers the affairs of Provincial Holdings Limited (PHL), a provincially owned crown corporation.

The lending program under the Commerce and Technology Act assists manufacturing, processing and selected service sectors of the provincial economy by providing financial assistance in support of new ventures and in support of expansions, growth or financial shortfalls of existing businesses. This program provides direct loans at preferred interest rates.

The primary purpose of PHL is to take equity positions and to provide financial assistance to qualifying New Brunswick firms. The financial history of both lending programs follows.

Loans - Commerce ...

COMMERCE AND TECHNOLOGY ACT
PROGRAM HISTORY
($ Thousands)

	1984-85	1985-86	1986-87	To 10.27.87
Balance, beginning of year	$13,294	$11,430	$11,166	$19,019
New loans	1,900	1,811	10,550	175
	15,194	13,241	21,716	19,194
Repayments	3,484	2,075	2,664	480
Write offs	280		33	
Balance, end of year	$11,430	$11,166	$19,019	$18,714
Provision for loss	$ 1,372	$ 853	$ 2,521	
Provision as a percentage of loan balance	12.0%	7.7%	13.3%	

Loans - Commerce ...

PROVINCIAL HOLDINGS LTD.
PROGRAM HISTORY
($ Thousands)

	1984-85	1985-86	1986-87	To 10.27.87
Balance, beginning of year	$14,104	$15,920	$21,391	$23,633
New loans	2,675	7,098	3,141	3,398
	16,779	23,018	24,532	27,031
Repayments	859	1,227	400	191
Write offs		400	499	135
Balance, end of year	$15,920	$21,391	$23,633	$26,705
Provision for loss	$ 3,740	$ 5,135	$ 5,765	
Provision as a percentage of loans	23.5%	24.0%	24.4%	

* Loan balances include any equity investment by PHL in the debtor company.

As at October 27, 1987 there were 22 loans outstanding within the Department and 38 loans outstanding within PHL. A brief analysis of both loan portfolios follows.

Loans - Commerce ...

COMMERCE AND TECHNOLOGY ACT
ANALYSIS OF LOANS
AS AT OCTOBER 27, 1987

Date of Issue	Total Loans Outstanding		Loans With Payments In Arrears	
	# Of Loans	$ Amount	# Of Loans	$ Amount
1977 and prior	9	$ 2,525,497	2	$ 345,000
1978 to 1982	2	360,056	1	55,556
1982 to 1983	2	1,523,594	1	63,473
1983 to 1984	2	571,471	1	121,771
1984 to 1985	2	1,208,606	1	750,000
1985 to 1986	1	1,800,000	1	1,800,000
1986 to 1987	2	10,550,000		
Current year	2	174,583	-	-
	22	$18,713,807	7	$ 3,135,800

PROVINCIAL HOLDINGS LTD.
ANALYSIS OF LOANS
AS AT OCTOBER 27, 1987

Date of Issue	Total Loans Outstanding		Loans With Payments In Arrears	
	# Of Loans	$ Amount	# Of Loans	$ Amount
1977 and prior	2	$ 907,873		$
1978 to 1982	4	2,314,797	2	456,818
1982 to 1983	3	8,206,250	1	2,050,000
1983 to 1984	2	1,550,000	2	1,550,000
1984 to 1985	2	538,002	1	150,000
1985 to 1986	5	6,648,000	2	2,735,000
1986 to 1987	8	3,141,423	2	270,000
Current year	12	3,398,263	3	1,750,000
	38	$26,704,608	13	$ 8,961,818

We have reviewed all loans outstanding as at October 27, 1987. Our observations and recommendations with respect to both the Department and PHL follow.

Loans - Commerce ...

Related Financial Statement Amounts

Like the Department of Fisheries, the Department of Commerce and Technology has other asset balances which are directly related to the lending program.

Property Held for Resale amounted to $7,664,704 as at October 27, 1987 and Accrued Interest Receivable amounted to $1,136,314.

Concentration of Loans

The 22 loans outstanding in the Department's lending program were made to 16 companies. The 38 loans outstanding in PHL are to 33 companies.

Loans with Payments in Arrears

As indicated in the loan analysis 7 of the 22 Department loans have payments in arrears while 13 of the 38 PHL loans have payments in arrears.

Collection Policy

Our review of loan files indicates consistent collection practices in both the Department and PHL. No significant weaknesses or deficiencies were noted.

Loans - Commerce ...

Loan Security

In most cases, there is security for the direct loans advanced under the terms of the Commerce and Technology Act. Most loans are secured by fixed and floating charge debentures having a second charge on the debtor's assets. Many loans have restrictions imposed on the debtor in areas such as capital additions, dividend payments and management salaries.

In one instance, the Department issued a loan without obtaining security.

Loss Experience

Over the past five years the Department has taken proceedings to collect direct loans amounting to $7,095,324. The total amount realized on forced collection of these loans amounted to $1,904,970. As at October 27, 1987 the Department has further actions pending on these defaulted loans and expects to realize an additional $955,000. Should this amount actually be realized the loss experienced related to these loans would be $4,235,354 or 59.7%.

During the same period, Provincial Holdings Ltd. has taken proceedings to collect advances amounting to $1,300,000. The total amount realized on forced collection of these advances amounted to $170,370 resulting in a loss of $1,129,630 or 86.9%.

In addition to the lending program, the Department provides loan guarantees to qualifying business.

Loans - Commerce ...

During the fiscal year 1983-84, the Department wrote off $45,925,063. This amount represented uncollectible accounts receivable, loans, loan interest and loan guarantees in both the Department and Provincial Holdings Limited.

Provision for Loss

The Department calculates its provision for loss based upon a loan by loan analysis. The provision for loss, as a percentage of total loans, has remained constant over the past three years in both the Department and Provincial Holdings Limited. As at March 31, 1987 the provisions for loss were $2,521,000 and $5,765,000 respectively.

Provision for Loss at October 27, 1987

The Department of Commerce and Technology reviewed both loan portfolios as at October 27, 1987 and recommends provisions for loss of $3,021,000 for loans under the Commerce and Technology Act and $7,791,000 for loans in PHL.

If the quality of these loan portfolios remains constant for the remainder of the year, then the provision for loss as at March 31, 1988 will likely be $2.5 million more than at March 31, 1987.

Loans - Commerce ...

RECOMMENDATION

1. Unless the quality of the loan portfolios improve significantly between October 27, 1987 and March 31, 1988, the Department's provision for loss on loans at March 31, 1988 should be at least $3 million and PHL's provision for loss on loans should be at least $7.8 million.

Department of Agriculture - $87.5 million

The Department of Agriculture is responsible for loan and advance programs under the Agriculture Development Act, the New Brunswick Crop Insurance Commission, the New Brunswick Hog Stabilization Fund, and the Swine Industry Assistance Program. Outstanding balances related to these programs at October 27, 1987 and March 31, 1987 stated in $ millions follow.

Program	Balances Outstanding at October 27	March 31
Agriculture Development Act	$77.9	$75.0
N. B. Crop Insurance Commission	3.7	5.7
N. B. Hog Stabilization Fund	3.8	4.1
Swine Industry Assistance Program	2.1	2.1
Total	$87.5	$86.9

Loans - Agriculture ...

Agriculture Development Act

The purpose of the lending program under the Agriculture Development Act is to assist primary producers to develop or expand viable farms in all regions of the Province. The program provides long term loans at preferred interest rates to primary producers, part-time farmers and agricultural linkage operations. Loans are provided for the purpose of acquiring land, making permanent improvements to land, and constructing and/or renovating farm structures.

The Act is administered by the Agriculture Development Board, a seven member group appointed by the Minister of Agriculture. In addition to approving loans, the Board can also acquire land and lease it to farm operators at preferred rates with an option to buy within five years at the Board's cost.

New Brunswick Crop Insurance Commission

The New Brunswick Crop Insurance Commission is made up of seven growers appointed by the Minister of Agriculture under the Crop Insurance Act and Regulations. The purpose of the commission is to administer the provincial crop insurance program. The administration costs are paid entirely by the Province.

The insurance premiums paid into the program are shared equally by the growers and the Government of Canada. Shortfalls are funded by loans from the Province with repayment to come from future fund surpluses.

Loans - Agriculture ...

New Brunswick Hog Stabilization Fund

The objective of the New Brunswick Hog Price Stabilization Fund, which is administered by the New Brunswick Hog Marketing Board, is to ensure efficient producers will not suffer financial loss during periods of depressed prices. The producer either contributes to the fund or receives payments from the fund depending on the relationship of hog market prices to a base price set at 98% of out of pocket operating costs. Because of depressed prices in the industry for a number of years, only 12 of 231 producers in the fund have a positive balance. The remaining 219 producers have borrowed from the fund. The financing for these loans from the fund is provided by the Department of Agriculture.

Swine Industry Assistance Program

The Swine Industry Assistance Program was designed to assist hog producers in 1982-83, when $2,500,000 was required to refinance bank operating loans and trade accounts. Loans under this program are interest bearing loans although in most cases a portion of the loans were frozen at 0% interest as a result of the 'set-aside' program instituted in 1984. The 'set-aside' program was a $5,300,000 program to assist hog producers who had loans under either the Swine Industry Assistance Program or the Agricultural Development Act and who had a debt level which was greater than the industry average.

Loans - Agriculture ...

AGRICULTURE DEVELOPMENT ACT
PROGRAM HISTORY
($ Thousands)

	1984-85	1985-86	1986-87	Period Ending 10.27.87
Balance beginning of year-including interest	$ 66,121	$ 70,120	$ 71,697	$ 75,015
New Loans	5,485	4,566	5,999	5,918
Interest and other charges - net	1,001	556	1,641	(860)
	72,607	75,242	79,337	80,073
Repayments	2,155	2,593	2,978	2,116
Write offs	332	952	1,344	18
Balance end of year	$ 70,120	$ 71,697	$ 75,015	$ 77,939
Provision for loss	$ 10,819	$ 18,932	$ 16,085	
Provision as a percentage of loans	15.4%	26.4%	21.4%	

Loans - Agriculture ...

NEW BRUNSWICK CROP INSURANCE COMMISSION
PROGRAM HISTORY
($ Thousands)

	1984-85	1985-86	1986-87	Period Ending 10.27.87
Balance beginning of year	$ 2,199	$ 4,744	$ 3,835	$ 5,661
Disbursements	2,540		2,032	
	4,739	4,744	5,867	5,661
Repayments/ adjustments	(5)	909	206	1,967
Balance end of year	$ 4,744	$ 3,835	$ 5,661	$ 3,694
Provision for loss	$ 3,558	$ 2,876	$ 5,436	
Provision as a percentage of balance	75.0%	75.0%	96.0%	

NEW BRUNSWICK HOG PRICE STABILIZATION FUND
PROGRAM HISTORY
($ Thousands)

	1984-85	1985-86	1986-87	Period Ending 10.27.87
Balance beginning of year	$ 2,811	$ 3,783	$ 5,164	$ 4,078
Loan disbursements	972	1,381	227	
	3,783	5,164	5,391	4,078
Repayments			905	313
Write-offs			408	
	$ 3,783	$ 5,164	$ 4,078	$ 3,765
Provision for loss	$ 796	$ 4,906	$ 3,870	
Provision as a percentage of balance	21.0%	95.0%	95.0%	

Loans - Agriculture ...

SWINE INDUSTRY ASSISTANCE PROGRAM
PROGRAM HISTORY
($ Thousands)

	1984-85	1985-86	1986-87	Period Ending 10.27.87
Balance beginning of year	$ 2,445	$ 2,437	$ 2,434	$ 2,148
Loan disbursements				
	2,445	2,437	2,434	2,148
Repayments/ adjustments	8	3	286	12
Balance end of year	$ 2,437	$ 2,434	$ 2,148	$ 2,136
Provision	$ 2,021	$ 2,311	$ 2,040	
Provision as a percentage of balance	83.0%	95.0%	95.0%	

Our review of loans, advances and investments held by the Department of Agriculture focused on loans provided under the Agriculture Development Act. Our procedures included a general review of the lending process, selected loan files, repayment schedules and repayment histories, loss experience, collection policies and procedures, and the adequacy of the provision for loss.

Our observations and recommendations follow:

Loans - Agriculture ...

Concentration of Loans

$33 million or 42% of the total dollars outstanding as at October 27, 1987 are concentrated in 300 loans to 108 borrowers. The remaining $44.9 million is made up of about 1500 individual loans.

Payment of Insurance and Property Taxes

The Board requires farmers with loans to carry life insurance sufficient to discharge the loan in the event of death. We have observed that annual premiums for many of these policies as well as property insurance premiums and property tax payments are being paid by the Board and charged to the loans.

Loans with Payments in Arrears

When one or more payments on a loan are in arrears the entire balance can be considered to be in default. The Board's current portfolio of loans includes 816 loans to 562 borrowers amounting to $39,826,000 which are in arrears by one or more payments. This represents more than 50% of the outstanding number of loans accounting for 51% of the total dollars outstanding.

Loans - Agriculture ...

Collection Policy

Our review of loan files indicated that many loans are permitted to remain in arrears for extensive periods of time without strong collection actions being undertaken.

Typical collection action on loans with payments in arrears include letters and visits from the Board and occasionally letters from the Board's solicitor.

The Department does not appear to have a clear policy on when and under what circumstances, repossession and disposal of encumbered assets should be used to collect loans in default.

Loan Security

The Board typically takes farm land and buildings as security for loans.

Prior to 1980-81 the Agriculture Technology Board acted as a lender of last resort. That is to say, no loans were issued unless the farmer had been rejected by all other lending institutions including the federal loan programs. Under this policy numerous loans were provided to farmers who had already assigned their farms to other agencies as security for loans. As a consequence the security for Board loans ranked second behind other lenders.

Loans - Agriculture ...

Loss Experience

In the five years ending March 31, 1987 the Agriculture Development Board took proceedings to collect 38 loans amounting to $4,642,000. The total amount realized on forced collection of these loans amounted to $1,894,000. The actual loss experienced was $2,748,000 or 59.2%.

As at October 27, 1987 the Board has outstanding repossession orders on 40 defaulted loans amounting to $7,839,830 and expects to realize $3,746,830 through the disposal of security. The anticipated loss will be $4,093,000 or 52.2%.

Provision for Loss

The Department uses a formula method to calculate the provision for loss on all loan and advance programs under its control.

The provision for loss on Agriculture Development Act loans has grown from 4.5% of the loan balances as at March 31, 1982 to 21.4% of those loan balances as at March 31, 1987.

The provision for losses on the Crop Insurance Commission advances, the Hog Stabilization Fund advances and the Swine Industry Assistance program are calculated at 95% of amounts outstanding.

The total provision for loss on loans and advances in the Department of Agriculture as at March 31, 1987 amounted to $27.4 million on loans and advances of $86.9 million.

Loans - Agriculture ...

Provision for Loss as at October 27, 1987

In order to assist us with our review of the Forecasted Revenue and Expenditures to March 31, 1988 we asked the Department to value 300 loans totalling $32.9 million issued under the Agriculture Development Act. The Department has recommended a provision for loss against these loans of $10,728,350 or 32.6% of the outstanding balances.

We have applied the results of this loan by loan analysis to the total outstanding loan balance as at October 27, 1987. The resulting provision for loss amounts to $25.4 million.

We have estimated the provision for loss on October 27, 1987 balances outstanding for the Crop Insurance Commission, the Hog Price Stabilization Fund and the Swine Industry Assistance Program by using the same percentage as used by the Department in prior years (95%). The resulting provision for loss on these loans amounts to $9 million.

The total estimated provision for loss on loans and advances outstanding as at October 27, 1987 amounts to $34.4 million on loans of $87.5 million.

If the quality of the loan portfolio remains the same at March 31, 1988, the provision for loss should be at least $34.4 million. This will represent an increase for the year of $7 million.

Loans - Agriculture ...

Lending Practices

The relative need to borrow funds does not appear to be a consideration when approving loans under the Agriculture Development Act. This is particularly evident in loans to part-time farmers and to corporations engaged in agricultural linkage operations.

Unlike full-time farmers, part-time farmers usually have other sources of income. Our review of loan files related to part-time farmers and our discussions of these files, with Board personnel did not reveal whether or not an individuals need for borrowed funds was fully considered prior to granting the loan. Some loan files suggest that the projects being funded could have been carried out without Board funding.

Need does not appear to be the key factor used when granting loans to corporate agricultural linkage operations. Our review of loan files related to this type of loan indicates that many applicants possessed significant equity and little long term debt. Information in some files indicated an ability to service conventional financing, no evidence of rejection by conventional lenders and, in some cases, that projects were substantially completed before the application was received.

Cost of Land Included in Loan Accounts

The Department operates a land lease program in conjunction with its lending program. The balance of Loans as at October 27, 1987 includes an amount of $6.5 million which represents the cost of approximately 35,000 acres of farm land owned by the Province.

Loans - Agriculture ...

The inclusion of land in this account appears to contradict the government's stated accounting policy of not recording the cost of real property in its financial statements.

Comments of the Comptroller

In his 1986 report the Comptroller had the following comments after a review of the Agricultural Development Board's loans program:

1. Existing policies, practices and procedures do not provide assurance that the loan portfolio is managed so as to minimize the potential financial loss to the Province.

2. Non compliance with many existing policies, practices and procedures has resulted in high risk applications having been approved without due regard for normal lending practices, ineffective collection procedures and the failure to undertake timely recovery action.

Our review indicates that these reported weaknesses have not yet been fully addressed.

Comments of the Auditor General

In the Auditor General's annual report for 1986, observations were made regarding the loan programs administered by the Agriculture Development Board and the New Brunswick Hog Price Stabilization Fund.

Loans - Agriculture ...

Para. 4.8 Property taxes and fire insurance premiums are paid on behalf of borrowers. These amounts are added to existing loan balances and carry the same interest rates as the original loan balances. Since the repayment schedules are not adjusted the loans will not be repaid within their agreed upon time periods.

Para. 4.14 Loans from the Hog Price Stabilization Fund may have reached a level not contemplated when the Fund was established. These loans to producers are unsecured, non-interest bearing and not formally acknowledged by the borrower and the program operates with no specific legislative mandate of its own.

RECOMMENDATIONS

1. The Department of Agriculture should consider doing a detailed evaluation of each loan in its portfolio. The provision for losses in future years should be determined, at least partially, on a loan by loan basis instead of by formula.

2. Unless significant changes occur in the Department's lending programs, the provision for loss as at March 31, 1988 should be at least $34.4 million. This would represent an increase of $7 million for the year.

3. The Department should be instructed to act on the recommendations of the Comptroller and the Auditor General.

Loans - Agriculture ...

4. Financial need should be used as one criteria in evaluating loan applications received under the Agriculture Development Act.

5. The Government should consider conducting an evaluation of the effectiveness of all lending programs within the Department of Agriculture.

6. The Government should examine the present practice of recording the cost of real property in the Department's records of Loans, Advances and Investments.

ACCOUNTS AND TAXES RECEIVABLE

Overview

Revenues and recoveries are recorded on an accrual basis as earned, except for payments from Canada under the Federal - Provincial Fiscal Arrangements, the Federal Post - Secondary Education and Health Contributions Act, and the Canada - New Brunswick Tax Collection Agreement. Payments from Canada under these agreements are based on estimates and are subject to adjustment in future years. These payments are recorded as revenue in the year received and adjusted only when Canada informs the Province of revisions to the amount paid.

Revenues and recoveries resulted in the recording of $250,878,228 in accounts and taxes receivable as at October 27, 1987. Details of this balance are as follows.

	Receivable	Provision for Loss
Due from Canada	$ 46,290,324	$
New Brunswick Liquor Corporation	10,932,248	
Departmental Receivables	49,589,484	17,215,733
Other Receivables	7,011,696	5,424,870
Taxes Receivable		
Property Taxes	53,474,893	8,691,895
Sales Taxes	53,413,995	4,610,963
Stumpage & Royalties	6,457,856	149,776
Fuel Taxes	12,036,075	1,519,520
Tobacco Taxes	9,141,580	34,197
Other Taxes	2,530,076	119,600
Total	$250,878,227	$ 37,766,554

Receivables ...

An explanation of the makeup of each of these balances, together with our observations and recommendations follow.

Receivables ...

Due from Canada

Details with respect to this balance are provided in a separate section entitled 'Claims on Canada'.

New Brunswick Liquor Corporation

This amount represents profits earned by the Corporation that, as of October 27, 1987, had not been paid to the Province. It also represents the Province's investment in this crown corporation.

Receivables ...

Departmental Receivables

The balances receivable by Departments as at October 27, 1987 are as follows.

Department/Program	Receivable	Provision for Loss
Agriculture	$ 528,480	$ 65,892
Alcohol & Drug Dependency	47,734	
Community Improvement	2,988,487	
Board of Management	1,068,560	
Commerce & Technology	599,365	232,847
Education	808,319	4,420
Finance	3,652,314	20,516
Fisheries	156,038	53,038
General Government	316,550	942
Health	5,270,430	230
Transportation	19,402,954	11,391,825
Justice	7,483,676	17,022
Labour	160,003	27,232
Legislative Assembly	1,018	613
Municipal Affairs	1,328,754	7,482
Natural Resources	2,187,535	18,588
N.B. Housing	818,724	
Advanced Education	900,075	14,120
Income Assistance	5,695,916	5,277,623
Supply & Services	2,079,553	83,074
Tourism, Recreation & Heritage	1,732,073	269
Other	4,890	
Total	57,231,448	17,215,733
Less interdepartmental account	7,641,964	
	$49,589,484	$17,215,733

Receivables ...

At year end interdepartmental accounts are removed from both accounts receivable and payable. During the year the accounts are not adjusted for interdepartmental amounts.

Details on the balances of departmental receivables as at October 27, 1987 follow.

Agriculture

Of the $528,480 receivable by the Department of Agriculture, $227,849 represents unpaid land lease fees on lands leased by the Agriculture Development Board and $272,478 represents unpaid veterinary fees.

The provision for loss includes $60,767 representing veterinary fees over one year old. According to the analysis provided by the Department, the total veterinary fees over one year old amount to $101,367.

RECOMMENDATIONS

1. In our opinion, an additional $40,000 should be added to the provision for loss against outstanding veterinary fees receivable as at October 27, 1987.

2. The land lease fees are closely related to the Agriculture Development Board loans on which a provision of 32.6% of the outstanding balance has been recommended. Accordingly, we recommend an additional $60,000 be added to the provision for loss on lease fees receivable as at October 27, 1987.

Receivables ...

Community Improvement Corporation

This balance relates to funds advanced by the Federal government for financing of the Moncton Core Agreement.

Board of Management

The receivable of $1,068,560 includes two large amounts. $590,622 represents an over charge by the Department of Supply and Services for the Personnel Management System acquired by the Board of Management and $462,433 represents amounts due from hospitals for pension payments.

The Board expects to collect all amounts outstanding.

Commerce and Technology

The receivable balance of the Department of Commerce and Technology includes two large balances - $354,074 in miscellaneous receivables and $164,837 in service fees receivable. The service fees relate to loan guarantee fees charged borrowers under the lending programs administered by the Department. The largest amount in the miscellaneous receivable accounts ($301,966), is owing by one company.

The Department has established a provision for loss in the amount of $232,847 against specific accounts receivable.

Receivables ...

Education

The Department of Education accounts receivable balance of $808,319 includes $203,500 owing by the Federal government for provincial Indian student education and $556,165 owing by the Federal government for non-resident Indian students from Quebec being educated in the New Brunswick school system.

The Department's provision for loss in the amount of $4,420 relates to outstanding non-resident student fees.

Finance

The Department of Finance accounts receivable balance of $3,652,314 includes $1,811,935 in accrued revenue from Lottery sales, royalties and privileges, $97,132 in succession duties owing by two estates, $258,026 from Brunswick Mining and Smelting for matured but unpresented bonds and $1,130,586 due from the sinking fund as the result of a bond redemption.

The Department's provision for loss in the amount of $20,516 represents specific accounts which the Department believes may be uncollectible.

Fisheries

The Department of Fisheries accounts receivable balance of $156,038 includes a receivable from the Department of Labour amounting to $103,000 (for job creation) and $43,774 in charter fees for Department owned vessels.

The Department's provision for loss of $53,038 includes all accounts receivable except for the Department of Labour.

Receivables ...

General Government

The balance of accounts receivable owing to General Government includes an estimate of sales taxes owing on liquor sales to private establishments amounting to $315,500.

The provision for loss of $942 includes all other accounts receivable.

Health

The Department of Health and Community Services accounts receivable balance of $5,270,430 includes $4,882,983 in amounts owing for services provided to out of province residents and advances to organizations such as the Red Cross, the V.O.N. and the Province of Nova Scotia for medical services provided to New Brunswick residents.

Transportation

The Department of Transportation accounts receivable balance of $19,402,954 includes $11,022,784 in unsatisfied judgement claims, $5,725,099 in inter-departmental receivables and $2,655,071 in receivables related to cost recovery charges to individuals, organizations and other governments.

The Department's provision for loss amounting to $11,391,825 includes a provision of $10,471,645 (95%) for unsatisfied judgement claims and a provision of $920,180 for specific cost recovery receivables.

Receivables ...

Justice

The Department of Justice accounts receivable balance of $7,483,676 includes $551,168 in amounts due from municipalities for police services, $1,198,300 in accrued revenues for various programs administered by the Department and $5,116,267 in estimated insurance premium taxes due for the period. The remainder includes amounts owing on court fines and the like.

The Department's provision for loss of $17,022 represents receivables owing to the Department for more than one year.

Labour

The Department of Labour accounts receivable balance of $160,003 represents recovery claims for engineering services provided by the Department.

The Department's provision for loss in the amount of $27,232 represents specific recovery claims receivable that the Department believes may be uncollectible.

Municipal Affairs

The Department of Municipal Affairs and Environment accounts receivable balance of $1,328,754 includes $763,387 in inter-departmental receivables and $565,367 in user fees receivable from property owners connected to sewer systems installed by the Province.

The Department's provision for loss of $7,482 represents specific user fees receivable.

Receivables ...

Natural Resources and Energy

The Department of Natural Resources and Energy accounts receivable balance of $2,187,535 includes accrued revenue for metallic mineral taxes of $882,000. The remainder represents specific receivables for services and $500,000 as an estimate of accrued hunting license revenue fees charged by the Department.

The Department's provision for loss of $18,588 represents specific receivables.

Advanced Education and Training

The accounts receivable balance of $900,075 represents unpaid training and tuition fees plus an inter-departmental receivable from the Department of Labour amounting to $37,480.

The Department's provision for loss amounting to $14,120 represents specific receivables.

New Brunswick Housing Corporation

The amount receivable from the corporation of $818,724 represents accrued interest revenue on outstanding housing loans.

Income Assistance

The accounts receivable balance of $5,695,916 includes $5,392,750 in social services over payments, $184,421 in repayable student bursaries and $118,745 in miscellaneous revenue accruals.

Receivables ...

The Department's provision for loss amounting to $5,277,623 is made up of a provision against student bursary repayments of $113,783 and a provision against social services over-payments of $5,163,840.

Supply and Services

The Department of Supply and Services accounts receivable balance of $2,079,553 includes $1,812,147 in inter-departmental charges receivable and $25,235 in receivables from individuals and organizations for purchases of goods or services.

The Department's provision for loss of $83,074 is not specifically allocated.

Tourism, Recreation and Heritage

The Department of Tourism, Recreation and Heritage accounts receivable balance of $1,732,073 includes $1,672,780 in inter-departmental charges to the Department of Labour for job creation and $59,293 in general receivables from individuals and organizations.

Receivables ...

Other Receivables

The balance of other receivables as at October 27, 1987 is made up as follows.

Department/Type	Receivable	Provision for Loss
Receivables resulting from honored guarantees:		
Agriculture	$ 3,267,564	$ 3,267,564
Commerce & Technology	2,156,064	2,156,064
Working capital advances by:		
Education	405,000	
Labour	210,000	
Salary, travel and other advances by all Departments	973,068	1,242
Total	$ 7,011,696	$ 5,424,870

The receivables resulting from honored guarantees are the residual amounts remaining after the Departments have disposed of all assets acquired as a consequence of guarantees being honored.

The working capital advances by the Department of Education include a $55,000 advance to the Workers' Compensation Board and a $350,000 advance to the Atlantic Provinces Special Education Authority.

The working capital advance by the Department of Labour is to the Workers' Compensation Board.

Receivables ...

Property Taxes Receivable

Collection of property taxes receivable is the responsibility of the Department of Finance. As at October 27, 1987 the balance of property taxes receivable recorded in the public accounts consisted of the following.

Type of Receivable	Amount	Provision for Loss
Real property taxes	$ 59,523,562	$ 8,691,895
Business taxes	17,599	
Business improvement taxes	79,948	
Reserve for uncollectibles	(6,146,216)	
Total	$ 53,474,893	$ 8,691,895

Property taxes receivable are generally well secured in that the value of property assessed typically exceeds the amount of outstanding property taxes by 10 or more times. In addition, property can be sold by tax sale if the taxes remain unpaid two years after assessment.

There are, however, certain types of properties that could be considered high risk. They are federally owned properties and non-residential properties owned by 'not for profit' organizations.

Our analysis of property taxes receivable as at October 27, 1987 indicates that the federal government owes about $13,700,000 in unpaid property taxes and that 'not for profit' organizations owe an additional $9,500,000.

Receivables ...

According to officials in the Department, the federal government will ultimately pay some portion of the outstanding property taxes as a grant in lieu. Traditionally the grant in lieu payments are made several years after the property taxes are assessed.

Outstanding property taxes by 'not for profit' organizations present a different type of problem. These organizations are normally funded by charity, the provincial government, the municipal governments or some combination of all three.

The difficulty here is their ability to pay and the consequences of proceeding with foreclosure to obtain payment. The likelihood of collecting all past due amounts from 'not for profit' organizations is difficult to predict.

The Department's provision for loss of $8.7 million and the reserve for uncollectibles of $6.1 million may not be sufficient to cover all possible losses from property taxes receivable.

RECOMMENDATIONS

1. Increase the provision for loss by an additional $5 million, in order to cover all possible losses from property taxes receivable.

2. Re-examine the policy of recording, as revenue, property taxes on federal and 'not for profit' organizations.

Receivables ...

Sales Taxes

Collection of sales taxes (social services and excise taxes) is the responsibility of the Department of Finance. As at October 27, 1987 the balance of sales taxes receivable amounted to $53,413,995.

The sales tax collection system is a self assessing system. That is to say, licensed vendors collect sales taxes, report the amount collected and remit it to the government on a monthly basis. The balance of sales taxes receivable at October 27, 1987 is made up as follows.

Type of Receivable	Amount	Provision for Loss
Estimated October collections	$ 48,178,399	
Reported but not remitted	7,674,124	$ 4,610,963
Reserve for uncollectibles	(2,438,528)	
Total	$ 53,413,995	$ 4,610,963

The estimate of October sales taxes collected but not remitted is based upon prior years experience.

Receivables ...

The balance of sales tax reported but not remitted is mostly sales tax, interest and penalties resulting from reassessments. An aged analysis of this balance follows.

Age	Amount
1 to 6 months	$ 2,239,620
6 months to 1 year	1,082,903
1 to 3 years	1,052,158
over 3 years	3,299,443
Total	$ 7,674,124

The reserve for uncollectibles of $2,438,528 includes $1,765,000 owing by two companies who are disputing liability for sales tax. The remainder represents the Department's estimate of remissions which will ultimately be sought by individuals or organizations that are entitled to purchase goods on a tax exempt basis.

The provision for loss of $4,610,963 represents specific accounts including an additional $1,701,000 relating to the two companies noted above. We believe that the reserve and provision are sufficient to account for possible losses as at October 27, 1987.

Receivables ...

Stumpage and Royalties

Collection of stumpage and royalty fees is the responsibility of the Department of Natural Resources and Energy. The balance receivable as at October 27, 1987 consists of the following.

Type of Receivable	Amount	Provision for Loss
Estimated fees for October	$ 3,144,287	
Accounts receivable	3,313,569	$ 149,776
Total	$ 6,457,856	$ 149,776

The Department's estimate of October fees is based on prior years history. The account receivable represents amounts owing by specific individuals or organizations. Our review indicates that the majority of these accounts receivable are current amounts.

The Department's estimated provision for loss of $149,776 represents specific accounts.

Receivables ...

Fuel Taxes

Collection of fuel taxes is the responsibility of the Department of Finance. The balance as at October 27, 1987 amounting to $12,036,075 consists of specific receivables of $1,913,115 and an estimate of October's taxes amounting to $10,122,960.

The Department's provision for loss amounting to $1,519,520 represents specific accounts. We believe the provision for loss at October 27, 1987 is adequate.

Receivables ...

Tobacco Taxes

Collection of tobacco taxes is the responsibility of the Department of Finance. The balance owing of $9,141,580 as at October 27, 1987 represents an estimate of taxes collectible for the month of October. The Department's provision for loss of $34,197 represents minor amounts outstanding.

Receivables ...

Other Taxes Receivable

The balance of other taxes receivable as at October 27, 1987 consists of the following amounts.

Type of Receivable	Amount	Provision for Loss
Receivable by former		
School Boards	$ 1,026	$ 1,026
County Governments	100,954	100,954
Amusement and Capital Taxes	2,428,096	17,620
Total	$ 2,530,076	$ 119,600

Collection of amusement taxes and capital taxes on banks and financial institutions is the responsibility of the Department of Finance. The receivable balance as at October 27, 1987 includes an estimate of capital taxes amounting to $2,320,000 and estimates of amusement taxes for the month of October amounting to $108,096.

The Department's provision for loss appears to be adequate as at October 27, 1987.

CLAIMS ON CANADA

As at October 27, 1987 outstanding Claims on Canada amounted to $46,290,000.

Due from Canada
($ thousands)

Department/Agreement	Amount
Department of Agriculture	$
Crop Insurance Agreement	580
Canadian International Development Agreement	299
Alcohol and Drug Dependency	
Vocational Rehabilitation of Disabled Persons	555
Community Improvement Corporation	
Forestry Renewal Agreement	1,967
Industrial Development Agreement	1,405
Fisheries Agreement	340
Industrial Innovation & Development Agreement	409
Tourism Agreement	1,415
Agri - Food Agreement	218
Department of Education	
Vocational Rehabilitation of Disabled Persons	1,189
Indian Student Agreement	1,408
General Government	
Infrastructure Development Agreement	5,301
Department of Health and Community Services	
Flood Damage Agreement	498
Canada Assistance Plan Agreement	4,622
Department of Transportation	
Flood Damage Agreement	552
Highway Improvement Agreement	4,962
Economic Regional Development Agreement	13,035
Grand Manan Airport Project	1,073
Department of Justice	
Bilingual Administration Agreement	257
Legal Aid Agreement	256
Young Offenders Agreement	663
Department of Municipal Affairs and Environment	
Flood Damage Agreement	2,653
Advanced Education and Training	
National Training Agreement	875
Department of Supply and Services	
Federal Sales Tax Agreement	366
All Other Agreements	1,392
Total	$ 46,290

Claims ...

We were instructed to review and comment on the status of Claims on Canada and on the procedures being followed in connection with such claims.

Our review of Claims on Canada focused on the process used to render claims on Canada and on the timeliness of their collection. We did not review all claims outstanding. We concentrated our review on claims rendered by the Community Improvement Corporation and by the Department of Transportation.

The Community Improvement Corporation administers the Economic and Regional Development Agreement and most sub-agreements attached thereto. In addition, it administers the General Technology Agreement. For most of these agreements, claims are made as expenditures are incurred on approved projects or activities. The Corporation calculates the claim based upon the sharing percentage stipulated in the agreement. On an annual basis the Province must provide an audited statement of expenditures in support of any claims submitted during the fiscal year under the agreement.

The Department of Transportation administers the Canada - New Brunswick Highway Improvement Agreement, the Grand Manan Airport Project and the highway sub-agreements under the Economic and Regional Development Agreement. Claims under these agreements are advanced as expenditures are made. The claim is calculated based upon the sharing percentage stipulated in the agreement. Periodically, an audited statement of expenditures related to projects funded under each agreement must be submitted to Canada.

Claims ...

The procedures for making claims under Federal - Provincial agreements appear to be well understood and followed by personnel within both Departments reviewed.

Copies of all claims submitted to Canada are forwarded to the Office of the Comptroller where they are recorded in an accounts receivable ledger. Payment advices are also submitted to the Office of the Comptroller for processing.

Our review indicates that claims are being prepared on a timely basis and that the amounts outstanding as at October 27, 1987 represent current claims.

No significant weaknesses or deficiencies were noted other than the comments raised by the Auditor General in paragraphs 5.17 to 5.32 of his 1987 annual report.

PROPERTY HELD FOR RESALE

The Property Held for Resale account, as represented on the balance sheet of the Province, consists of properties acquired by Departments through foreclosures related primarily to lending and guarantee programs. A breakdown of this account by Department follows.

Department	($ Millions) Recorded Cost	Provision for Loss
Commerce and Technology	$ 7.5	$ 1.2
Fisheries	4.8	2.4
Supply and Services	.3	
Total	$ 12.6	$ 3.6

Commerce and Technology

As at October 27, 1987 the Department of Commerce and Technology holds 9 properties acquired through foreclosure. All 9 properties have been held for more than 2 years and 6 have been held for more than 5 years.

The most significant property held in this group is 120 acres of industrial park land in Moncton. This property accounts for $5.5 million of the $7.5 million recorded cost. It was acquired in 1985-86.

In addition to the Moncton industrial park land, this account also includes other parcels of land and several buildings. Some properties held in this account are presently being leased.

Doane Raymond

Property ...

The provision for loss of $1.2 million is the Department's estimate of the difference between market value and recorded value for these properties. It should be noted that market values, once established by the Department, are generally not changed. In some instances the market values used by the Department are five years old.

Our review of information available in Commerce and Technology indicates that other industrial park lands are held by the Department. These other properties are not included in the Property for Resale account. Presumably they were either acquired in the past with capital funds or are not for sale.

Department of Fisheries

As at October 27, 1987 the Department of Fisheries holds 9 vessels in the Property Held for Resale account. Four of these vessels were acquired in 1987 through repossessions. The remaining 5 were acquired in 1974-1975. The make up of the Department's Property Held for Resale account is as follows.

Date Acquired	Vessel Name	Recorded Cost	Provision for Loss
1974	Suzanne P	$ 913,500	
1974	Judith G	1,261,800	
1974	Louise P	176,900	
1975	Lady Shippegan	1,653,700	
1975	Laurie Elizabeth	685,900	
1987	4 vessels	111,300	
Total		$ 4,803,100	$ 2,438,400

Property ...

The provision for loss is an estimate provided by the Department. The Department did not provide an allocation of the provision by vessel.

The three vessels acquired in 1974 are 107 foot offshore fishing vessels. The Suzanne P is currently under lease to a fish processing company. The lease revenue received on this vessel, in the past, has not been sufficient to cover operating costs. The Judith G is also reported to be under lease to a fish processing company. However, information supplied to us by a fisheries officer suggests that this vessel is beached near Caraquet. The Louise P has not been used in several years. A recent offer of $6,100 has been received on this vessel.

The Lady Shippegan and the Laurie Elizabeth are both 116 foot offshore fishing vessels. Both are reported to be under lease to fish processing companies.

Since acquisition in 1974-75, vessels owned by the Department have been leased to various companies. The Department's records indicate that over the past decade Departmental expenditures to maintain these vessels have amounted to about $10 million. Over the same period lease revenue has amounted to about $500,000. Until 1986-87 the annual loss on leasing was charged to the Property Held for Resale account. A portion of the operating loss on these vessels was written off prior to March 31,1987. Since April 1, 1987 the loss on leasing these vessels has been charged to the Department's operating budget.

Property ...

Supply and Services

As at October 27, 1987 the Department of Supply and Services held numerous properties acquired through property tax foreclosures. These properties are offered to the public for sale. The Department expects to realize sufficient funds on disposal to recover the related outstanding property taxes.

General Observations

It is not the Province's policy to record physical assets, except for vehicles, on its balance sheet. Capital spending becomes a charge to net debt. Yet assets acquired by foreclosure or default, related to lending programs, are recorded in Property Held for Resale, a balance sheet account. This appears to result in inconsistent treatment, particularly when the Property Held for Resale account is used to hold assets in use by the Province (i.e. leased).

One possible explanation for this apparent inconsistency is that, by replacing a loan with an asset, no loss is recorded as an expenditure out of ordinary revenue until such time as the asset is ultimately sold or the provision for loss is increased.

RECOMMENDATIONS

1. In order to promote a conservative basis of accounting, Departments with Property Held for Resale should fully provide for loss on all properties held for a period of more than two years. When these properties are ultimately sold, the proceeds would be recorded as ordinary account revenue.

Property ...

2. Expenditures required to maintain assets held in the Property for Resale Accounts should be charged against the Department's operating budget. Revenue earned on these assets should be included in ordinary revenue accounts.

3. Annually, the Board of Management should review each Departments intentions with respect to each property held in Property Held for Resale.

4. The Government should consider consolidating all assets held for resale in one Department charged with disposal responsibilities.

5. If these recommendations are accepted, the provision for loss on Property Held for Resale as at October 27, 1987 would increase by $8.7 million. This would represent an increase in the provision for loss in the Department of Commerce and Technology of $6.3 million and $2.4 million in the Department of Fisheries.

CONTINGENT LIABILITIES

Contingencies are the result of existing conditions or situations involving uncertainty that will ultimately be resolved when one or more future events occur or fail to occur. Contingencies typically result from such matters as pending or threatened litigation, guarantees of indebtedness of others and indemnities.

The stated accounting policy of the Province requires disclosure of contingent liabilities with respect to guarantees of the indebtedness of others. It is silent on whether contingent liabilities with respect to litigations and indemnities should be disclosed.

Our review did not address the desirability of recognizing contingent liabilities for litigations and indemnities. We focused on the contingent liability for guarantees of others' indebtedness.

As at October 27, 1987 the Province is contingently liable for guarantees amounting to $2.5 billion. This amount is slightly lower than the balance outstanding as at March 31, 1987.

Contingencies ...

	($ Millions) Total Debt Guaranteed	Provision for Loss
Bond and Debentures		
Commerce and Technology Act	$ 13.9	$
Municipal Finance Corporation Act	129.0	
Electric Power Act	1,344.0	
Bank Loans		
Commerce and Technology Act	109.4	13.0
Fisheries Development Act	1.9	
Nursing Home Act	26.9	
Livestock Incentive Act	1.2	.2
Farm Machinery Loans Act	.3	
Farm Adjustment Act	3.2	.8
Electric Power Act	.9	
Loans From Canada		
Employment Loans	1.4	
New Brunswick Housing Act	53.7	
Electric Power Act	374.7	
Accrued Interest and Foreign Exchange	466.3	
Total	$2,526.8	$ 14.0

Annually the Departments responsible for administering debt guarantee programs establish a provision for loss on guaranteed loans. The provision is their estimate of the potential cost to the Province resulting from guarantees currently in place. It is estimated on a case by case basis and reflects the Departments' views of the likelihood that the Province will be called upon to honour its guarantees and the ultimate cost of doing so.

As at October 27, 1987 the Departments have established a provision for loss on debt guarantees amounting to $14 million. This provision for loss appears adequate as at October 27, 1987.

FINANCIAL COMMITMENTS

Financial commitments are obligations to outside organizations or individuals that become liabilities if and when terms of existing contracts, agreements or legislation are met.

In the normal course of government, Departments commit budgeted funds to program activities. The extent to which Departments expect to satisfy these commitments, with funds remaining in their 1987-88 budgets, is reflected in the quarterly budget reports.

In addition to annual program commitments, the Province has a number of financial commitments that are expected to extend beyond the end of the current fiscal year. These include commitments under property and equipment leases, commitments under capital construction projects, and commitments to provide grants under various Departmental programs.

The Province's annual financial statements disclose financial commitments for property and equipment leases and for grants under the Clean Environment Act and the Municipal Assistance Act.

The following table presents estimates of the financial commitments existing as at October 27, 1987. The allocation of commitments between the remainder of 1987-88 and future years assumes that budgets for capital construction projects will be expended by March 31, 1988 and that conditions attached to approved grants and loans will be satisfied by year end.

Commitments ...

Commitments under:	($ millions) Total	Remainder of 1987-88	Future Commitments
Property Leases	$ 69.6	$ 3.1	$ 66.5
Equipment Leases	19.4	2.5	16.9
Capital Construction Projects	88.0	74.0	14.0
Grant Programs	101.8	4.9	96.9
Loan Programs	16.1	16.1	
Total	$ 294.9	$ 100.6	$ 194.3

Property and Equipment Leases

The financial commitments under property and equipment leases are disclosed annually in the Province's financial statements. In addition, our report on Leasing and Leasing Practices provides more details on this subject.

Capital Construction Projects

The financial commitments associated with capital construction projects represent outstanding amounts required under contracts in force at October 27, 1987.

Commitments by Type of Construction
($ Millions)

Type of Construction	Total Financial Commitment	Remainder of 1987-88	Estimated Future Commitment	Estimated Costs to Completion
Bridges and Highways	$ 40	$ 40	$	$
Hospitals				204
Schools	48	34	14	
Total	$ 88	$ 74	$ 14	$ 204

* Estimated costs to complete hospital construction, provided by the Department of Supply and Services, are subject to change.

Commitments ...

Bridge and Highway construction is carried out by the Department of Transportation. Financial commitments provided by this Department as at October 27, 1987 represent unpaid amounts under construction contracts.

Hospital construction is carried out by the Department of Supply and Services. Commitments provided by this Department as at October 27, 1987 amounting to $204 million represent the estimated cost to complete 6 major construction projects. While some of these estimated costs are committed under contract, most will be contracted in future years. Accordingly, no amount has been included in financial commitments.

School construction is carried out by the Department of Supply and Services. Financial commitments provided by this Department as at October 27, 1987 represent obligations to contractors. Of the $48 million in obligations to existing contractors, the Department has budgeted to pay $34 million during the remainder of 1987-88. The remaining $14 million will become obligations for future years.

RECOMMENDATION

1. The Government should consider disclosure of financial commitments for capital construction in the Province's annual financial statements.

Commitments ...

Grant Programs

The $101.8 million commitment under grant programs consists of $4.9 in commitments made by the Department of Commerce and Technology and $96.9 million in commitments made by the Department of Municipal Affairs and Environment.

Under the Commerce and Technology Act the Department of Commerce and Technology provides grants to support small industries. As at October 27, 1987 the Department is committed to paying $4.9 million on 350 approved grant applications. The criteria established for this program require the applicants to fulfill certain conditions prior to the payment of these funds. The Department's unexpended budget as at October 27, 1987 is not sufficient to allow full payment of these commitments by March 31, 1988. If all the criteria related to these grants are met by the applicants before March 31, 1988 the Department will need to request a supplementary appropriation or a Special Warrant.

The Department of Municipal Affairs and Environment provides unconditional grants to municipal governments under the Clean Environment Act and the Municipal Assistance Act. As at October 27, 1987 outstanding commitments for grants under these programs amount to $96.9 million. These amounts are payable to municipalities over the next 15 to 20 years. These commitments are disclosed annually in the Province's financial statements.

Commitments ...

RECOMMENDATION

1. The Government should consider disclosure of financial commitments for grants under the Commerce and Technology Act in the Province's annual financial statements.

Commitments ...

Loan Programs

A number of Departments administer lending programs in support of specific industries or activities. As at October 27, 1987 the following Departments had approved the following loan amounts for payment.

Department	($ Millions) Amount
Agriculture	$ 4.3
Commerce and Technology	3.6
Fisheries	8.2
Total	$ 16.1

Most of these loans are expected to be paid to borrowers before March 31, 1988. For more details on the Province's lending programs see our report on Loans, Advances and Investments.

CAPITAL CONSTRUCTION IN PROGRESS

In the five years ending on March 31, 1987 the Province has spent over $1,300 million on capital projects. In 1987-88 an additional $384 million will likely be spent. Capital construction is a major activity of the Provincial government and a major contributor to net debt.

Our review of capital construction focused on the tendering process, budgetary control and on cost and completion date overruns. Our objective was to assess the financial management of construction projects and to identify any significant weaknesses or deficiencies. Our review included capital construction projects within the Department of Supply and Services and the Department of Transportation.

Department of Supply and Services

The 1987-88 capital budget for the Department of Supply and Services amounts to $154,987,000. These funds are intended to fund the following type of construction.

Hospital Construction	$ 63,150,000
School Construction	52,895,000
Other Construction	38,942,000
Total	$154,987,000

Construction ...

The capital budgets for hospital and school construction were provided, for the most part, to continue projects started in prior years. The budget for other construction is intended to fund the construction or renovation of other Provincially owned buildings and properties.

Hospital Construction

The Department acquired responsibility for hospital construction in 1986 from the Department of Health and Community Services. The 6 major hospital construction projects in progress as at October 27, 1987 were under construction in 1986.

The commencement dates, originally expected completion dates and original budgets for these 6 projects are as follows.

Construction ...

HOSPITAL CONSTRUCTION IN PROGRESS
AS AT OCTOBER 27, 1987
($ MILLIONS)

Hospital	Original Budget	Original Completion Date	Commencement Date	Estimated Years to Complete
Campbellton	$40,000	1987	1981	6
Edmundston	30,000	1985	1978	7
Dumont	20,000	1988	1983	5
Moncton	52,000	1988	1979	9
Sackville	11,000	1985	1982	3
Tracadie	14,000	1988	1981	7
Total	$167,000			

As at October 27, 1987 none of the above projects were complete. Revised estimates of cost and completion dates supplied to us by the Department are as follows.

HOSPITAL CONSTRUCTION IN PROGRESS
AS AT OCTOBER 27, 1987
($ MILLIONS)

Hospital	Revised Budget	Revised Completion Date	Commencement Date	Estimated Years to Complete
Campbellton	$83,200	1990	1981	9
Edmundston	74,500	1989	1978	11
Dumont	42,000	1990	1983	7
Moncton	130,600	1992	1979	13
Sackville	17,800	1988	1982	6
Tracadie	28,900	1991	1981	10
Total	$377,000			

* Revised budgets and completion dates, provided by the Department, are subject to change.

Construction ...

OBSERVATIONS

Cost and Completion Date Overruns

Departmental records indicate that $173 million has been spent to date on construction of these 6 hospitals and that an additional $204 million will be required to completion. The original budget of $167 million has more than doubled to $377 million and the time required to complete has increased from an average of 6 years to 9 years. Current estimates of cost and completion dates are subject to change.

Budgetary Control

Supply and Services, like all Departments, budgets for capital expenditures on an annual basis. As a consequence, the cumulative costs of construction in relation to the total estimated budget are not controlled to the same extent as are expenditures against the current year's budget. The emphasis appears to be on maximizing the use of the current year's budget.

Given the extent of cost overruns in relation to original budgets, we conclude that construction budgets have not been an effective control.

Tendering Process

The Department has clearly defined procedures for tendering capital construction. We did not find any weaknesses or deficiencies in the process or its use. However, it should be noted that construction of these 6 hospitals was not tendered to general contractors.

Construction ...

For these projects, project management consultants were engaged to coordinate and control all aspects of construction. Individual aspects of construction are being tendered for as required. Contracts with the project consultants do not contain any penalties for cost overruns or for delays in completion.

Our review was not extensive enough to determine what effect, if any, this approach to construction has had on the cost of these projects.

Estimated Costs to Completion

Given the delays in completion and cost overruns experienced to date, we are unable to comment on the accuracy or reliability of the Department's estimated costs to completion of the hospitals currently under construction. However, it is important to note that current estimates are stated in 1987 dollars.

Reasons for Delays in Completion

We were unable to ascertain what, in fact, caused the delays in completing these hospitals on time. Management has suggested that one reason was inadequate funding in the initial years of construction. Information supplied by management tends to support their reasoning.

Construction ...

Impact of Delays

Delays in construction frequently result in increased costs. The costs of goods and services typically increase by some amount each year. Therefore, part of the increased cost of these projects can reasonably be attributed to delays in construction.

Another impact has been to increase net debt without providing usable assets. We estimate that the interest cost associated with expenditures to date is approximately $25 million. Interest costs over the period of construction could amount to as much as $130 million before these hospitals are complete.

We have been advised by personnel in Supply and Services that most buildings require roof maintenance every 10 or so years. Several of the hospitals under construction could require roof maintenance before completion.

Financial Management and Control

The transfer of responsibility for these construction projects while in progress, the focus of budgetary control on annual expenditures rather than cumulative expenditures, the contracting out of construction management, and inadequate funding in past years could all have been contributing factors in reducing the effectiveness of financial management and control over these projects.

Construction ...

RECOMMENDATIONS

1. The Department of Supply and Services should examine the existing management, control and accountability structure as it relates to hospital construction with a view to simplifying and improving control over existing construction projects.

2. The Department of Supply and Services should consider accounting for capital construction on a project basis rather than on a fiscal year basis. This would enable management to control expenditures against budget for the duration of a project rather than on a year to year basis.

3. The Department of Supply and Services should re-examine the current estimated costs of completion for each project and verify their accuracy. Reasons for the time required to complete each project should be documented.

   Accountability for successful completion of existing projects on time and within budget should be clearly assigned within the Department of Supply and Services.

4. The Department of Supply and Services should re-examine the present timetable for completion of each hospital in progress. An analysis should be prepared of the potential impact on the forecasted cost to complete, assuming that the timetable to completion could be advanced and additional funds could be made available in 1988-89.

Construction ...

5. The Government should explore options for completing these 6 projects on a least cost basis. Options could include:

   - prioritize projects in order to advance completion dates;
   - altering the timetable for completion in order to reduce costs to complete; and
   - tendering responsibility for completion of some or all projects to general contractors at fixed prices with penalties for cost overruns and completion delays.

Construction ...

School Construction

The Department of Supply and Services is also responsible for school construction. As at October 27, 1987 the Department was involved in 59 school construction projects. The current year's budget for school construction amounted to $53 million. As at October 27, 1987 the Department's records indicate that $28 million had been spent.

Our review of management information, related to school construction, indicates that the typical period required to construct a school or a school expansion ranges from 1 to 3 years. The following table shows the number of school construction projects currently in progress and the approved project costs.

SCHOOL CONSTRUCTION IN PROGRESS
AS AT OCTOBER 27, 1987
($ Thousands)

Construction Projects By Year Commenced	Approved Number of Schools	Estimated Project Cost
1986 and prior	10	$ 34,337
1986-87	34	108,734
1987-88	15	41,692
Total in Progress	59	$184,763

Construction ...

OBSERVATIONS

Tendering School Construction

The Department typically uses one of two approaches for construction of schools. They either phase construction by tendering specific elements of construction to contractors over time or they tender the entire contract to a general contractor who becomes responsible for all construction activity. In both instances appropriate tendering procedures appear to have been observed.

Construction Contract Change Orders

Our analysis of change orders processed against school construction projects in progress indicates that about 700 change orders have been granted totalling approximately $1.7 million. This represents about a 1% increase over the related original contract amounts of $126 million.

Cost Overruns on Construction in Progress

The ultimate amount of cost overruns on construction in progress cannot be forecast with any degree of certainty. However our review of contracts that are essentially complete or nearing completion indicated cost overruns of about $1.5 million on approved costs of $20.5 million. This represents an 8% cost overrun.

Construction ...

Budgetary Control

Accountability for school construction appears to be clearly defined within Supply and Services. Construction projects are controlled within the Department and completion delays and cost overruns appear to be kept within reasonable boundaries.

Financial Management and Control

Our review of school construction in progress as at October 27, 1987 did not reveal any significant weaknesses in financial management and control of capital construction in progress.

Department of Transportation

The Department of Transportation is responsible for construction of most provincial highways and bridges. The Department's capital budget for 1987-88 amounts to $173 million.

Public tendering is the normal approach to contracting for capital construction of highways and bridges. Our review indicates that 182 construction contracts valued at $109 million were in various stages of completion as at October 27, 1987. Each contract is monitored and controlled from the date of award to completion. No significant weaknesses or deficiencies were noted in the Department's systems and practices related to capital construction.

LEASING AND LEASING PRACTICES

Overview

The leasing of accommodations has become an accepted method of acquiring space for government operations. Although there are no figures available to demonstrate growth in the amount of space under lease, it is generally believed that leasing has become the preferred method of acquiring space in the past decade.

By acquiring space under lease, instead of through construction or purchase of buildings, the Province avoids capital expenditures by increasing annual operating expenditures. In 1986-87 the annual expenditure for property under lease amounted to approximately $12 million. This amount includes about $8 million of minimum lease payments and $4 million of operating expenses.

Responsibility for negotiating, administering and funding of government lease agreements is generally assigned to the Department of Supply and Services. We have noted that property leasing activities are also conducted by the Department of Advanced Education and Training, Crown Corporations, and various Commissions and Boards. Our review was restricted to leases administered by the Department of Supply and Services as at October 27, 1987.

Leasing ...

The typical procedure for acquisition of leased space by the Department of Supply and Services follows:

- User Departments develop proposals for new programs. The proposal is presented to the Board of Management for approval. The outline of financial implications of the programs normally do not include the cost of accommodation.

- User Departments request accommodations from the Department of Supply and Services in writing, with specifications.

- The Department of Supply and Services attempts to find suitable space either in a government owned building or in existing leased facilities. Failing this, the Department searches for suitable rental facilities and prepares plans and specifications.

  Terms for a lease are tentatively agreed to with the landlord. An effort is made to find funding in the current year, firstly in the user Department budget and secondly in the Department of Supply and Services budget.

- A proposal is submitted to the Board of Management and, if approved, negotiations are completed with the landlord and a lease is signed.

Leasing ...

The accommodations division of the Department of Supply and Services has primary responsibility for leasing activities. According to the Department's organization chart, there is one full-time person involved in the leasing activity.

Leasing ...

DEPARTMENT OF SUPPLY AND SERVICES
SCHEDULE OF LEASED SPACE
BY LOCATION
AS AT OCTOBER 27, 1987

LOCATION	NUMBER OF LEASES	NUMBER OF LANDLORDS	SQUARE FOOTAGE UNDER LEASE
Bathurst	5	4	12,000
Campbellton	6	5	38,000
Edmundston	7	2	60,000
Fredericton	46	15	565,000
Moncton	8	7	95,000
Saint John	8	5	60,000
All Other Locations	66	59	145,000
TOTAL	146	97	975,000

SCHEDULE OF LEASED SPACE
BY TERM OF LEASE
AS AT OCTOBER 27, 1987

Terms of Lease	Number of Leases	Square Footage Under Lease
Month to Month	51	125,000
12 to 59 Months	54	215,000
60 to 179 Months	26	195,000
180 Months and over	15	440,000
TOTAL	146	975,000

Leasing ...

OBSERVATIONS

Type of Facilities

In reviewing the various leases we determined that about 75% of leased accommodations are for office-type space. The remaining 25% is primarily warehouse and storage.

Cost of Leasing

The cost of leasing typically includes minimum lease payments, usually expressed as a cost per square foot, and costs of operating the leased space. In order to properly assess the cost of leasing, both cost factors must be considered. We reviewed the cost figures provided to us and found significant variances from lease to lease. The average cost of office space is in the range of $12 to $16 per square foot. Factors influencing the cost per square foot include the location, the quality of leased space and the age of the lease. One lease, in Fredericton, has a cost of greater than $20 per square foot.

Given the number of leases and lease locations and the differences in age and quality of accommodations, we were unable to conduct a thorough market comparison of lease costs to current market values. However, we believe that the average cost of $12 to $16 per square foot for office space falls within the accepted current market range for Fredericton.

Leasing ...

Lease Terms

Two issues arise from our analysis of lease terms that we believe are significant.

The first is the number of leases (51) and associated square footage space (125,000 sq. ft.) that is currently being leased on a month to month basis. If this space is required for government operations, longer term leases may provide more beneficial lease rates.

The second, is the amount of space (440,000 sq. ft.) leased on terms exceeding 15 years. Over such lengthy periods accommodation requirements tend to change. Leases of this duration may reduce the government's ability to respond to the changing requirements of Departments.

Leasehold Improvements

We have been advised that in the majority of cases, landlords are asked to provide leasehold improvements requested by the Government. A working relationship with the landlords, and in some cases written contracts, are the method by which this activity is conducted.

Leaseholds normally become a capital expenditure paid for by the Province. However in one case, the lease contract provided for financing of the leaseholds by the landlord with the monthly rent payment increased accordingly.

Leasing ...

Leasing Sole Use Properties

In several instances the Department has entered into long term leases for most or even all of the space contained within a building. For these leases, no evidence was available to indicate that purchasing or constructing the property was considered as an option to leasing. In addition, no calculations were available to indicate that the Department compared the cost of future lease payments with the cost of ownership by the Province. Based on our own calculations, it would appear that at the time of entering into the lease agreements, it would have been more economical for the Province to purchase or construct some of these buildings instead of leasing them.

Linking Annual Lease Payments to Landlords' Fixed Financing Rate

In a few cases leases contained clauses whereby increases or decreases in the owners' fixed financing costs were transferred to the Province. In one particular lease, the payments allowed the landlord to amortize a mortgage financed at an 18% interest rate. This rate was in excess of the Province's costs of long term borrowing at the time.

Responsibility for Payment of Operating Expenses

Typically, lease agreements require the Province to share in the cost of common expenses such as heat, utilities, taxes,insurance, repairs, etc. Some of the lease agreements do not provide enough restrictions on the landlord in terms of the nature of these expenses nor do they require the landlord to sufficiently substantiate the cost. The Auditor General made specific mention of this problem in his 1986 Annual Report (paragraphs 4.179 to 4.190).

Leasing ...

Generally Accepted Leasing Practices

Prudent business practices for major users of lease space include:

- shopping for lease space whenever alternative accommodations exist. Tendering and inviting proposals are common methods of shopping for lease space;

- obtaining and comparing square footage rates for various lease terms (i.e. 1, 3, 5 and 10 year terms);

- comparing total costs of alternatives in terms of price, quality and location;

- evaluating alternatives such as build or buy when accommodation requirements exceed a pre-determined size and perceived need is long term;

- establishing standard lease agreements or lease clauses that convey standard user specifications in terms of accommodation quality, escalator clauses, terms under which any portion of common property operating costs will be reimbursed, etc; and,

- long range planning for lease space requirements such that tentative plans can be established for such eventualities as alternate use of space under lease and selective renewal of leases to match expected needs.

Leasing ...

Inviting Proposals

We were advised that the Province has never invited proposals or requested tenders for lease space.

Use of Standard Form Lease Agreements

At present, the Province does not use standard form lease agreements. All existing leases are based on documents prepared by the landlords.

This practice tends to give the landlord an advantage during lease negotiations.

In addition, without standard form leases, leasing personnel must become familiar with each clause of each lease in order to effectively administer lease properties and lease payments.

Leasing Guidelines and Procedures

At present the Department does not have adequate written guidelines and procedures to guide user Departments or leasing personnel. As a consequence,

- buy or build is generally not considered as an alternative to leasing;
- inviting proposals for space or leaseholds is not routinely considered;
- controlling operating expenses and other costs passed on by the landlords has been difficult.

Leasing ...

In summary, the lack of adequate written guidelines and procedures reduces the probability that the costs of accommodations are the most economical available.

In one instance we noted lease terms that provided the landlord with double payment of certain operating expenses. This has been brought to the landlord's attention and is now under review.

Planning for Future Needs

There appears to be a general lack of planning for future lease space requirements. We expected to find documentation from user Departments on their future space needs. However, advance notice of future space requirements does not appear to be available during the annual budget preparation process.

Our review of the leasing practices in the Department suggest that personnel deal with space needs as they arise. As such their function is reactive rather than proactive.

Leasing Activities in Other Departments

We noted that long term leasing activities were being conducted by certain other Departments, Crown Corporations, Boards, etc. One lease entered into by another Department appears to provide lease space that exceeds the price and quality of other leases for accommodations put to similar use.

Leasing ...

Leases for Capital Equipment

During our review of Departmental expenditures we noted numerous leases for equipment ranging from postage machines to computers. Most leases observed could best be described as capital leases.

Accepted accounting practices dictate that capital leases be treated as acquisitions rather than as leases. The Government's stated accounting policy is silent on the treatment of capital leases although the present practice is to treat them as ordinary leases and include annual payments in ordinary expenditures.

At present capital leases have been used only to acquire equipment. However, the possibility exists that Departments may use capital leases as a method of acquiring buildings. If so, the financial position of the Province could be materially misstated.

RECOMMENDATIONS

1. The Department of Supply and Services should consider establishing written space procurement procedures that ensure due regard for economy is observed in fulfilling all future space requirements.

2. The Department of Supply and Services should consider developing standard lease agreements containing clauses that ensure administrative efficiency and economy in the procurement of lease space.

Leasing ...

3. The Government should consider the advisability of relocating all leasing activities to the Department of Supply and Services particularly in those instances where long term commitments are being made.

4. The Government should consider the advisability of requiring user Departments to annually forecast their space requirements for the next 3 years.

5. A review should be undertaken of all existing leases of office space that require lease payments in excess of $16 per square foot.

6. Review procedures followed for presentations to the Board of Management to ensure that accommodation requirements and costs are adequately addressed.

7. Consider maintaining annual statistics on accommodations being used. The information could be assembled by Department and by program. The purpose would be to provide information that would help monitor growth in government accommodations in relation to growth in government programs.

8. In order to prevent the misuse of capital leasing as a means to acquire real property, we recommend that the Province adopt the CICA accounting treatment for capital leases. This recommendation, if retroactively applied, would increase the net debt position of the Province as at March 31, 1987 by approximately $16.7 million.

PERSONNEL CONTROLS

The Province employs more than 11,000 people on a full time and part time basis. Job classification, salary classification and payroll services are provided centrally, based on input from the Departments.

Our external review has not identified any significant weaknesses or deficiencies in personnel controls. There is, however, one matter related to personnel controls that warrants attention. That is the current development of a new human resources information system.

Development began in 1984-85 when the Province leased a computer and purchased a new personnel software package. The cost to date for developing this new system amounts to about $3 million. Future operating costs are expected to be about $2.3 million per year. The system is expected to provide much needed personnel management information in addition to processing payrolls.

Control procedures for the new system will differ substantially from those associated with the present system. In addition to training personnel to use the new system, substantial testing of security, accounting and processing controls will be necessary before the new system can be fully relied upon.